Lindabury, McCormick, Estabrook & Cooper, P.C.
53 Cardinal Drive
Westfield, New Jersey 07091
Tel: (908) 233-6800
Fax: (908) 233-5078
Attorneys for Third-Party Defendant Alliance Chemical, Inc.

NEW JERSEY DEPARTMENT OF ENVIRONMENTAL PROTECTION and THE ADMINISTRATOR OF THE NEW JERSEY SPILL COMPENSATION FUND,	SUPERIOR COURT OF NEW JERSEY LAW DIVISION: ESSEX COUNTY DOCKET NO. L-9868-05 (PASR)
Plaintiffs,	CIVIL ACTION
vs.	
OCCIDENTAL CHEMICAL CORPORATION, TIERRA SOLUTIONS, INC., MAXUS ENERGY CORPORATION, REPSOL YPF, S.A., YPF, S.A., YPF HOLDINGS, INC. and CLH HOLDINGS, INC.,	**CERTIFICATION OF ROBERT G. BREDE**
Defendants.	
MAXUS ENERGY CORPORATION and TIERRA SOLUTIONS, INC., Third-Party Plaintiffs,	
vs.	
3M COMPANY, et al.,	
Third-Party Defendants.	

I, Robert G. Brede, being of full age, do hereby certify as follows:

1. I am the Vice President and Secretary-Treasurer for Pfister Chemical, Inc., P.O. Box 237, Ridgefield, New Jersey 07657 ("Pfister").

2. I have been employed by Pfister for 49 years and am familiar with the company's corporate history and affiliates.

3. I also serve as Vice President and Secretary-Treasurer for Alliance Chemical, Inc. ("Alliance").

4. Alliance is a wholly-owned subsidiary of Pfister.

5. Alliance owned a portion of the property located at 309-337 Avenue P, Newark, New Jersey (the "Site") from 1965 until 2006 when the Site was sold.

6. Alliance operated a chemical manufacturing plant at the Site until 2001 when it ceased operations.

7. Pfister also owned a portion of the Site prior to its sale in 2006.

8. Pfister Urban Renewal Corporation, P.O. Box 237, Ridgefield, New Jersey 07657 ("PURC") is also a wholly-owned subsidiary of Pfister and a related entity to Alliance.

9. PURC was formed for the purpose of taking title to, and owned, a portion of the Site prior to its sale.

10. Alliance has been named as a Third-Party Defendant in the aforementioned litigation in connection with the Site, as well as at the D & J Trucking site, located at 310-336 Avenue P, Newark, New Jersey, and the Avenue P Landfill site, located at 357-405 Avenue P, Newark New Jersey. Alliance has denied the allegations with regard to all of said sites.

11. Alliance has agreed to enter into a Consent Judgment by and among the Plaintiffs and certain Third-Party Defendants for the purpose of settling the aforementioned litigation ("Consent Judgment").

12. Plaintiffs have agreed to include Pfister and PURC as "Unnamed Affiliated Entities" pursuant to Schedule I of the Consent Judgment.

I hereby certify that the foregoing statements made by me are true. I am aware that if any of the foregoing statements made by me are willfully false, I am subject to punishment.

Date: 4-23-13

Robert G. Brede

NEW JERSEY DEPARTMENT OF ENVIRONMENTAL PROTECTION, THE COMMISSIONER OF THE NEW JERSEY ENVIRONMENTAL PROTECTION AGENCY, and THE ADMINISTRATOR OF THE NEW JERSEY SPILL COMPENSATION FUND, Plaintiffs, vs. OCCIDENTAL CHEMICAL CORPORATION, TIERRA SOLUTIONS, INC., MAXUS ENERGY CORPORATION, REPSOL YPF, S.A., YPF, S.A., YPF HOLDINGS, INC. and CLH HOLDINGS, Defendants; MAXUS ENERGY CORPORATION and TIERRA SOLUTIONS, INC., Third-Party Plaintiffs, vs. 3M COMPANY, et al., Third-Party Defendants.	SUPERIOR COURT OF NEW JERSEY LAW DIVISION Docket No.: ESX-L-9868-05 (PASR) Civil Action **VERIFICATION OF ROBIN E. LAMPKIN, ESQ. IN SUPPORT OF ASHLAND INC.'S, ASHLAND INTERNATIONAL HOLDINGS, INC.'S AND ISP CHEMICALS LLC'S SETTLEMENT PAYMENT UNDER THE PROPOSED CONSENT JUDGMENT**

ROBIN E. LAMPKIN, of full age, hereby verifies as follows:

1. I am Senior Group Counsel at Ashland Inc. ("Ashland"). I have personal knowledge of the matters set forth herein.

2. Ashland and its wholly owned subsidiary, Ashland International Holdings, Inc. ("AIH"), were each named as third-party defendants in the within Passaic River Litigation matter for Ashland's former Drew Chemical Site located on Harrison Avenue, Kearny, New Jersey (the "Drew Site").

3. A true and correct copy of the allegations contained in Third-Party Complaint B relating to the Drew Site are attached hereto as Exhibit A.

4. AIH is a wholly-owned subsidiary of Ashland and has always been within the larger umbrella of the Ashland corporate family. Indeed, Ashland is the corporate parent to AIH. A true and correct copy of the April 15, 2013 Dunn & Bradstreet ("D&B") Report for AIH. is attached hereto as Exhibit B.

5. ISP Chemicals LLC (improperly named as ISP Chemicals Inc.) was named as a third-party defendant in the within Passaic River Litigation matter for the former Van Dyk Site located on William Street in Bellville, New Jersey (the "Van Dyk Site").

6. A true and correct copy of the allegations contained in Third-Party Complaint B relating to the Van Dyke Site are attached hereto as Exhibit C.

7. Ashland is the corporate parent of ISP Chemicals LLC. A true and correct copy of the April 15, 2013 D&B Report for ISP Chemicals LLC is attached hereto as Exhibit D. I make no representation as to the current status of the entity listed as ISP Chemicals Inc. in Exhibit D.

I certify that the foregoing statements made by me are true. I am aware that if any of the foregoing statements made by me are willfully false, I am subject to punishment.

ROBIN E. LAMPKIN, ESQ.

Dated: April 26, 2013

EXHIBIT A

Courtesy Copy

Joseph Patella, Esq.
ANDREWS KURTH LLP
450 Lexington Avenue, 15th Floor,
New York, New York 10017
Tel: 609.716.6500
Fax: 609.799.7000

Thomas E. Starnes, Esq.
Charles M. Crout, Esq.
ANDREWS KURTH LLP
1350 I Street NW
Suite 1100
Washington, DC 20005
Tel: 202.662.2700
Fax: 202.662.2739

NEW JERSEY DEPARTMENT OF ENVIRONMENTAL PROTECTION, THE COMMISSIONER OF THE NEW JERSEY ENVIRONMENTAL PROTECTION AGENCY, and THE ADMINISTRATOR OF THE NEW JERSEY SPILL COMPENSATION FUND,

Plaintiffs,

vs.

OCCIDENTAL CHEMICAL CORPORATION, TIERRA SOLUTIONS, INC., MAXUS ENERGY CORPORATION, REPSOL YPF, S.A., YPF, S.A., YPF HOLDINGS, INC. and CLH HOLDINGS,

Defendants,

MAXUS ENERGY CORPORATION and TIERRA SOLUTIONS, INC.,

Third-Party Plaintiffs,

vs.

3M COMPANY,
A.C.C., INC.,
ACH FOOD COMPANIES, INC.,
ACTIVE OIL SERVICE,
ADCO CHEMICAL COMPANY,
AGC CHEMICALS AMERICAS, INC.,

SUPERIOR COURT OF NEW JERSEY

LAW DIVISION - ESSEX COUNTY
DOCKET NO. L-009868-05

ALDEN-LEEDS, INC.,
ALLIANCE CHEMICAL, INC.,
ALUMAX MILL PRODUCTS, INC.,
AMCOL REALTY CO.,
AMERICAN INKS AND COATINGS CORPORATION,
APEXICAL, INC.,
APOLAN INTERNATIONAL, INC.,
ARKEMA, INC.,
ASHLAND INC.,
ASHLAND INTERNATIONAL HOLDINGS, INC.,
ASSOCIATED AUTO BODY & TRUCKS, INC.,
ATLAS REFINERY, INC.,
AUTOMATIC ELECTRO-PLATING CORP.,
AKZO NOBEL COATINGS, INC.,
BASF CATALYSTS LLC,
BASF CONSTRUCTION CHEMICALS INC.,
BASF CORPORATION,
BAYER CORPORATION,
BEAZER EAST, INC.,
BELLEVILLE INDUSTRIAL CENTER,
BENJAMIN MOORE & COMPANY,
BEROL CORPORATION,
B-LINE TRUCKING, INC.,
BORDEN & REMINGTON CORP.,
C.S. OSBORNE & CO.,
CAMPBELL FOUNDRY COMPANY,
CASCHEM, INC.,
CBS CORPORATION,
CELANESE LTD.,
CHEMICAL COMPOUNDS INC.,
CHEMTURA CORPORATION,
CLEAN EARTH OF NORTH JERSEY, INC.,
COSMOPOLITAN GRAPHICS CORPORATION,
CIBA CORPORATION,
COLTEC INDUSTRIES INC.,
COLUMBIA TERMINALS, INC.,
COMO TEXTILE PRINTS, INC.,
CONAGRA PANAMA, INC.;
CONOPCO, INC.,
CONSOLIDATED RAIL CORPORATION,
COOK & DUNN PAINT CORPORATION,
COSAN CHEMICAL CORPORATION,
COVANTA ESSEX COMPANY,
CRODA, INC.,
CRUCIBLE MATERIALS CORPORATION,
CURTISS-WRIGHT CORPORATION,
CWC INDUSTRIES, INC.,
DARLING INTERNATIONAL, INC.,
DAVANNE REALTY CO.,
DELEET MERCHANDISING CORPORATION,
DELVAL INK AND COLOR, INCORPORATED,

DILORENZO PROPERTIES COMPANY, L.P.,
E.I. DU PONT DE NEMOURS AND COMPANY,
EASTMAN KODAK COMPANY,
EDEN WOOD CORPORATION,
ELAN CHEMICAL COMPANY, INC.,
EM SERGEANT PULP & CHEMICAL CO.,
EMERALD HILTON DAVIS, LLC,
ESSEX CHEMICAL CORPORATION,
EXXON MOBIL
F.E.R. PLATING, INC.,
FINE ORGANICS CORPORATION,
FISKE BROTHERS REFINING COMPANY,
FLEXON INDUSTRIES CORPORATION,
FLINT GROUP INCORPORATED,
FORT JAMES CORPORATION,
FOUNDRY STREET CORPORATION,
FRANKLIN-BURLINGTON PLASTICS, INC.,
GARFIELD MOLDING COMPANY, INC.,
GENERAL CABLE INDUSTRIES, INC.;
GENERAL DYNAMICS CORPORATION,
GENERAL ELECTRIC COMPANY,
GENTEK HOLDING LLC,
GIVAUDAN FRAGRANCES CORPORATION,
G. J. CHEMICAL CO.,
GOODY PRODUCTS, INC.,
GORDON TERMINAL SERVICE CO. OF N.J., INC.,
HARRISON SUPPLY COMPANY,
HARTZ MOUNTAIN CORPORATION,
HAVENICK ASSOCIATES L.P.,
HEXCEL CORPORATION,
HEXION SPECIALTY CHEMICALS, INC.,
HOFFMANN-LA ROCHE INC.,
HONEYWELL INTERNATIONAL INC.,
HOUGHTON INTERNATIONAL INC.,
HUDSON TOOL & DIE COMPANY, INC,
HY-GRADE ELECTROPLATING CO.,
ICI AMERICAS INC.,
INNOSPEC ACTIVE CHEMICALS LLC,
INX INTERNATIONAL INK CO.,
ISP CHEMICALS INC.,
ITT CORPORATION,
KEARNY SMELTING & REFINING CORP.,
KAO BRANDS COMPANY,
KOEHLER-BRIGHT STAR, INC.,
LINDE, INC.,
LUCENT TECHNOLOGIES, INC.,
MACE ADHESIVES & COATINGS COMPANY, INC.,
MALLINCKRODT INC.,
MERCK & CO., INC.,
METAL MANAGEMENT NORTHEAST, INC.,
MI HOLDINGS, INC.,

MILLER ENVIRONMENTAL GROUP, INC.,
MORTON INTERNATIONAL, INC.,
N L INDUSTRIES, INC.,
NAPPWOOD LAND CORPORATION,
NATIONAL FUEL OIL, INC.,
NATIONAL-STANDARD, LLC,
NELL-JOY INDUSTRIES, INC.,
NESTLE U.S.A., INC.,
NEW JERSEY TRANSIT CORPORATION,
NEWS AMERICA, INC.,
NEWS PUBLISHING AUSTRALIA LIMITED,
NORPAK CORPORATION,
NOVELIS CORPORATION,
ORANGE AND ROCKLAND UTILITIES, INC.,
OTIS ELEVATOR COMPANY,
PRC-DESOTO INTERNATIONAL, INC.,
PASSAIC PIONEERS PROPERTIES COMPANY,
PFIZER INC.,
PHARMACIA CORPORATION,
PHELPS DODGE INDUSTRIES, INC.,
PHILBRO, INC.,
PITT-CONSOL CHEMICAL COMPANY,
PIVOTAL UTILITY HOLDINGS, INC.,
PPG INDUSTRIES, INC.,
PRC-DESOTO INTERNATIONAL, INC.,
PRAXAIR, INC.,
PRECISION MANUFACTURING GROUP, LLC,
PRENTISS INCORPORATED,
PROCTER & GAMBLE MANUFACTURING COMPANY,
PRYSMIAN COMMUNICATIONS CABLES AND
SYSTEMS USA LLC,
PSEG FOSSIL LLC,
PUBLIC SERVICE ELECTRIC AND GAS COMPANY,
PURDUE PHARMA TECHNOLOGIES, INC.,
QUALA SYSTEMS, INC.,
QUALITY CARRIERS, INC.,
RECKITT BENCKISER, INC.,
REICHHOLD, INC.,
REVERE SMELTING & REFINING CORPORATION,
REXAM BEVERAGE CAN COMPANY,
ROMAN ASPHALT CORPORATION,
ROYCE ASSOCIATES, A LIMITED PARTNERSHIP,
R.T. VANDERBILT COMPANY, INC.,
RUTHERFORD CHEMICALS LLC,
S&A REALTY ASSOCIATES, INC.,
SCHERING CORPORATION,
SEQUA CORPORATION,
SETON COMPANY,
SIEMENS WATER TECHNOLOGIES CORP.
SINGER SEWING COMPANY
SPECTRASERV, INC.,

STWB, INC.,
SUN CHEMICAL CORPORATION,
SVP WORLDWIDE, LLC,
TATE & LYLE INGREDIENTS AMERICAS, INC.,
TEVA PHARMACEUTICALS USA, INC.,
TEVAL CORP.,
TEXTRON INC.,
THE DIAL CORPORATION,
THE DUNDEE WATER POWER AND LAND COMPANY,
THE NEWARK GROUP, INC.,
THE OKONITE COMPANY, INC.,
THE SHERWIN-WILLIAMS COMPANY,
THE STANLEY WORKS,
THE VALSPAR CORPRATION,
THIRTY-THREE QUEEN REALTY INC.,
THREE COUNTY VOLKSWAGEN CORPORATION,
TIDEWATER BALING CORP.,
TIFFANY & CO.,
TIMCO, INC.,
TRIMAX BUILDING PRODUCTS, INC.,
TROY CHEMICAL CORPORATION, INC.,
UNIVERSAL OIL PRODUCTS COMPANY,
V. OTTILIO & SONS, INC.,
VELSICOL CHEMICAL CORPORATION,
VEOLIA ES TECHNICAL SOLUTIONS, L.L.C.,
VERTELLUS SPECIALTIES INC.,
VITUSA CORP.,
VULCAN MATERIALS COMPANY,
W.A.S. TERMINALS CORPORATION,
W.A.S. TERMINALS, INC.,
W.C. INDUSTRIES,
WHITTAKER CORPORATION,
WIGGINS PLASTICS, INC.,
ZENECA INC.,

Third-Party Defendants.

MAXUS ENERGY CORPORATION'S AND TIERRA SOLUTIONS, INC.'S

THIRD-PARTY COMPLAINT "B"

Defendants Maxus Energy Corporation ("Maxus") and Tierra Solutions, Inc. ("Tierra") bring this Third-Party Complaint against the herein named Third-Party Defendants, and allege as follows:

1002. Hazardous Substances and other compounds have been detected in the soil at the Dial Site, including, but not limited to, beryllium, copper, lead, zinc, and total petroleum hydrocarbons.

1003. The Dial Corporation, as successor to Armour-Dial, is a discharger" and/or a Person "in any way responsible" for the Hazardous Substances that were discharged at the Dial Site and released into the Newark Bay Complex.

1004. On information and belief, Davanne Realty Co. is a Person "in any way responsible" for the Hazardous Substances that were discharged at the Dial Site and released into the Newark Bay Complex.

Drew Chemical Site

1005. The Drew Chemical Corporation property consists of real property and associated improvements at or about 1106 Harrison Avenue in Kearny, NJ 07032 ("Drew Chemical Site"). The Drew Chemical Site covers approximately six acres and contains several buildings used for production and warehousing. The Drew Chemical Site is located in the 100-year floodplain.

1006. The Drew Chemical Site operated as a production and warehouse facility which produced boiler compounds, paint defoamers, water treatment chemicals and other specialty chemicals.

1007. Drew Chemical Corporation ("Drew Chemical") was founded in 1941 and incorporated in the State of Delaware. Upon information and belief, Drew Chemical commenced operations at the Drew Chemical Site in 1970.

1008. On Information and belief, Ashland Oil, Inc. acquired Drew Chemical in 1981 and has operated the Drew Chemical Site from 1981 through the present.

1009. On information and belief, Drew Chemical was a wholly-owned subsidiary of Ashland Oil, Inc., but operated as a division of Ashland Chemical Company, a division of Ashland Oil, Inc., at the time Ashland Oil, Inc. owned and operated the Drew Chemical Site.

1010. Ashland Chemical Company, a division of Ashland Oil, Inc., became Ashland Chemical, Inc., a wholly-owned subsidiary of Ashland Oil, Inc. on October 1, 1989. Drew Chemical transferred all of its operating assets, including the Drew Chemical Site, to Ashland Chemical, Inc. on October 1, 1989.

1011. On information and belief, Ashland Oil, Inc. changed its name to Ashland Inc. in 1995.

1012. In 1999, Ashland Inc. formed two new divisions - Ashland Distribution Company and Ashland Specialty Chemical Company - from Ashland Chemical Company. On information and belief, the Drew Chemical Site is currently owned and operated by Ashland Specialty Chemical, a division of Ashland Inc. Ashland Inc. is responsible for actions of Ashland Chemical Company at the Drew Chemical Site.

1013. Drew Chemical merged with and into Valvoline Holdings, Inc. on or about May 31, 1996 and Valvoline Holdings, Inc. was the surviving corporation. Valvoline Holdings, Inc. changed its name to Ashland International Holdings, Inc.

1014. On information and belief, Ashland International Holdings, Inc. is the successor to Drew Chemical and, therefore, succeeds to Drew Chemical's environmental liabilities related to the Drew Chemical Site.

1015. Drew Chemical utilized, processed, handled, stored and/or Discharged Hazardous Substances and other compounds at the Drew Chemical Site, including, but not limited to, trichlorophenol, phenol (cresylic acid), ortho benyl chlorophenol, phosphoric acid, isopropanol, acetic acid, 1,1,1 trichloroethane, sodium hydroxide, zinc chloride, organic phosphorus, dichlorotoluene, mineral spirits, ethylene diamine, methanol, methylene chloride, tetrachlorethylene, butyl alcohol, isobutyl alcohol, toluene, mineral seal oil, morpholine, dichlorotoluene, formic acid, triethanolamine, acrylamide, acrylic acid, aluminum sulfate, ammonium bicarbonate, ammonium bifluoride, benzoic acid, chromium, magnesium, iron, copper, ethylene glycol, zinc compounds, acrylamide, diethylamine, dodecylbenzene sulfonic, butanol, ferric chloride, ferrous sulfate, hydrazine, methyl ethyl ketone, sodium bisulfite, sodium chromate, sodium hypochlorite, sulfuric acid, zinc nitrate, zinc sulfate, epichlorohydrin, and chromium compounds.

1016. The majority of the Drew Chemical Site was curbed and sloped inward, directing runoff to storm drains across the site and combined sewers which go to the PVSC in Newark. Storm drains at the Drew Chemical Site flowed to a neutralization tank which ultimately discharged to the Worthington

Avenue combined sewer. Runoff from the parking area flowed directly to the Worthington Avenue combined sewer.

1017. On information and belief, a drainage ditch along the southern side of the Drew Chemical Site flowed to a combined sewer along Greenfield Avenue which goes to the PVSC in Newark. Thirty aboveground tanks ranging in size from 4,200 to 15,000 gallons were located along the southern edge of the Drew Chemical Site as late as 1993.

1018. The Drew Chemical Site's combined sewer collection system collects approximately seventy percent of the site's entire surface area. Stormwater, process wastewater and spills are combined within the combined sewer collection system and are ultimately discharged to the PVSC.

1019. According to correspondence sent on behalf of Drew Chemical to the City of Kearny Building Inspector on January 29, 1971, plant effluent containing process area floor washdowns discharged into the Worthington Avenue combined sewer.

1020. On or about November 15, 1982, Drew Chemical notified the PVSC that Drew Chemical began discharging washdown water in a reactor vessel at the Drew Chemical Site to the Worthington Avenue CSO during the week of November 10, 1982.

1021. According to Drew Chemical's PVSC Waste Effluent Survey responses, Drew Chemical discharged effluent containing chromium, calcium, magnesium, iron, and copper to the PVSC sewer based on a sample taken at the Drew Chemical Site on July 6, 1972.

1022. The Drew Chemical Site is located within the Worthington Avenue Combined Sewer Overflow District ("Worthington Avenue CSO"). Upon information and belief, during wet weather events, a portion of the combined flow within the Worthington Avenue CSO enters an interceptor and discharges through an outfall line into the Passaic River

1023. Hazardous Substances and other compounds have been detected in the soil at the Drew Chemical Site, including, but not limited to, anthracene, fluoranthene, pyrene, butyl benzyl phthalate, bis 2 (ethyl hexyl), phthalate, chrysene, di-n-octylphthalate, benzo(b)fluoranthene, 4-methylphenol, 2-methyl naphthalene, trimethyl/napthalene, isomer, PCB, toluene, 1-methylnapthalene, phenanthrene, benzo (a) anthracene, benzo (k) fluoranthene, and benzo (a) pyrene.

1024. Hazardous Substances and other compounds similar to those that have been Discharged from the Drew Chemical Site have been detected in sediment core samples taken from the Passaic River adjacent to the Drew Chemical Site, including, but not limited to, magnesium, copper, aluminum, manganese, silver, chromium, zinc, toluene, and methyl ethyl ketone.

1025. Ashland International Holdings, Inc. as successor to Drew Chemical is a "discharger" and/or a Person "in any way responsible" for the Hazardous Substances that were discharged at the Drew Chemical Site and released into the Newark Bay Complex.

Dundee Canal Site

1026. The Dundee Canal consists of real property and associated improvements located in Passaic County, New Jersey along the Passaic River and running south from Dundee Dam ("Dundee Canal Site").

1027. On or about March 15, 1832, The Dundee Water Power and Land Company ("Dundee Water") was incorporated in the State of New Jersey and in approximately 1861, Dundee Water completed construction of the Dundee Canal Site. Dundee Water is a subsidiary of United Water Resources, Inc.

1028. Upon information and belief, the Dundee Canal Site was utilized for a variety of industrial purposes, including transportation.

1029. Upon information and belief, the Dundee Canal Site received direct discharges of Hazardous Substances and other compounds and storm water runoff from adjacent industrial facilities, including direct discharges of industrial wastewater from one or more paper mills.

1030. In approximately 1994-1995, investigations of the Dundee Canal Site indicated the presence of wood, tires, and miscellaneous debris in and along the Dundee Canal Site. At least one discharge pipe was observed extending into the Dundee Canal Site from an adjacent industrial facility. Other pipes were observed crossing the Dundee Canal Site.

EXHIBIT B

DNBi®
Risk Management

Printed By: Patrick DiDomenico
Date Printed: April 15, 2013

Live Report : ASHLAND INTERNATIONAL HOLDINGS INC

D-U-N-S® Number: 96-166-8969
Trade Names: (SUBSIDIARY OF ASHLAND INC., COVINGTON, KY)
Endorsement/Billing Reference: pdidomenico@gibbonslaw .com

D&B Address

Address	1000 Ashland Dr Russell, KY - 41169	**Location Type**	Single (Subsidiary)
Phone	606 329-3333	**Web**	www.ashland.com
Fax			

Endorsement : pdidomenico@gibbonslaw.com

Company Summary

Currency: Shown in USD unless otherwise indicated

Score Bar

PAYDEX®	NA
Commercial Credit Score Class	5
Financial Stress Score Class	3
Credit Limit - D&B Conservative	750.00
D&B Rating	ERN

D&B Company Overview

This is a single (subsidiary) location

Chief Executive	PAUL SHELLGREN, CEO
Year Started	1975
Employees	undetermined
SIC	6799
Line of business	Holding company
NAICS	523910
History Status	CLEAR

Commercial Credit Score Class

5 4 3 2 1

High Low

Company News

Today: Monday, April 15, 2013

Deutsche Bank Raises PT on Ashland (ASH) to
2013-04-15T10:01:23 AKDT 10:01

Ashland stock rockets to all-time high
2013-04-15T07:51:18 AKDT 7:51 AM-CincyBiz Blog -

Ashland Given New $105.00 Price Target at Credit
2013-04-15T04:42:46 AKDT 4:42 AM-Localized USA

Ashland Inc. (ASH) Surged To Over A 2-Month High
2013-04-15T02:57:52 AKDT 2:57 AM-RTTNews

Ashland Inc. (ASH) Has Risen To Over A 2-Month
2013-04-12T10:01:57 AKDT 10:01 AM-RTTNews

JANA Partners Discloses Ashland (ASH) Stake
2013-04-12T08:03:42 AKDT 8:03 AM-market folly

Activist Investor Jana Buys Stake in Chemicals
2013-04-11T14:00:28 AKDT 2:00 PM-MONEY NEWS

Ashland Inc. second-quarter earnings webcast
2013-04-10T08:19:39 AKDT 8:19 AM-Ashland Inc.

ENEA INVEST Ltd. Named Official Valvoline™
2013-04-10T07:59:49 AKDT 7:59 AM-WebWire

Ashland to increase epoxy vinyl ester resins
2013-04-03T02:11:20 AKDT 2:11 AM-Plast Info

Ashland Rises On Unusually High Volume (ASH)
2013-04-02T09:08:42 AKDT 9:08 AM-TheStreet.com

ASHLAND INC. : to increase epoxy vinyl ester
2013-03-28T03:18:23 AKDT 3:18 AM-4-Traders

Analyst Downgrades: Cliffs Natural Resources,
2013-03-27T09:04:17 AKDT 9:04

PAYDEX® Trend Chart

D&B does not have enough information on this company to build a PAYDEX Trend Chart.

Detailed Trade Risk Insight™

No Detailed Trade Data is available for this D-U-N-S® Number

Ashland CFO Chambers to retire in July
2013-03-25T09:02:29 AKDT 9:02 AM-Bloomberg

Ashland Inc. announces CFO succession plan
2013-03-25T08:18:12 AKDT 8:18 AM-Ashland Inc.

Ashland to Enter Russian Composite Resins
2013-03-19T13:07:30 AKDT 1:07 PM-American

Ashland Inc. announces intermediates and
2013-03-17T21:05:33 AKDT 9:05 PM-Coatings World

Powered by FirstRain

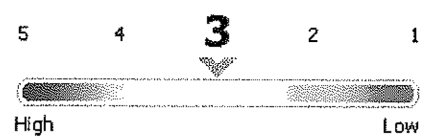
Public Filings

The following data includes both open and closed filings found in D&B's database on this company.

Record Type	Number of Records	Most Recent Filing Date
Bankruptcies	0	-
Judgments	0	-
Liens	0	-
Suits	0	-
UCCs	0	-

The public record items contained herein may have been paid, terminated, vacated or released prior to todays date.

Financial Stress Score Class



Corporate Linkage

Parent

Company	City , State	D-U-N-S® NUMBER
ASHLAND INC.	COVINGTON , Kentucky	00-500-3264

Subsidiaries (International)

Company	City , Country	D-U-N-S® NUMBER
Ashland Austria GmbH i.L.	BRUNN AM GEBIRGE , AUSTRIA	30-387-6197

ASHLAND - PLÁSTICOS DE PORTUGAL, LDA	LISBON , PORTUGAL	33-816-6697
Ashland Deutschland GmbH	KREFELD , GERMANY	34-436-9202
ASHLAND CHEMICAL HISPANIA SL	BENICARLO , SPAIN	46-001-6827
ASHLAND INDUSTRIES HISPANIA SOCIEDAD ANONIMA	TARRAGONA , SPAIN	46-002-7444
ASHLAND NEW ZEALAND LIMITED	Auckland, , NEW ZEALAND	59-041-8588
ASHLAND PACIFIC PTY. LTD.	GREENSBOROUGH , AUSTRALIA	75-050-1256
Ashland Chemical de México, S.A. de C.V.	MEXICO CITY , MEXICO	81-199-8152
ASHLAND INDUSTRIES IRELAND LTD	Dublin , IRELAND	98-834-3323

Affiliates (Domestic)

Company	City , State	D-U-N-S® NUMBER
HERCULES INCORPORATED	WILMINGTON , Delaware	00-131-5647
VAVOLINE INSTANT OIL CHANGE	YUMA , Arizona	00-511-1765
INTERNATIONAL SPECIALTY HOLDINGS, INC	WAYNE , New Jersey	13-541-2562
ISP SYNTHETIC ELASTOMERS LLC	PORT NECHES , Texas	13-571-7622
APAC-FLORIDA, INC.	JACKSONVILLE , Florida	92-978-3728
ISP REALTY CORPORATION	WAYNE , New Jersey	55-646-1010
ISP ENVIRONMENTAL SERVICES INC.	WAYNE , New Jersey	79-694-9246
ISP INVESTMENTS INC	WAYNE , New Jersey	79-696-0367
ASHLAND OVERSEAS INVESTMENTS INC	SAINT PAUL , Minnesota	80-018-9177
VALVOLINE INTERNATIONAL, INC.	LEXINGTON , Kentucky	86-125-1684
INTERNATIONAL SPECIALTY PRODUCTS INC.	WAYNE , New Jersey	96-437-8459
VALVOLINE, INC.	LEXINGTON , Kentucky	60-502-0486
ASHLAND DISTRIBUTION COMPANY	TWINSBURG , Ohio	01-835-6142
ASHLAND COMMUNITY MEDICAL EQUIPMENT, INC.	ASHLAND , Kentucky	18-144-4126
ISP FREETOWN FINE CHEMICALS INC.	ASSONET , Massachusetts	07-841-3716
AQUALON COMPANY	WILMINGTON , Delaware	05-273-4235

Affiliates (International)

Company	City , Country	D-U-N-S® NUMBER
Ashland Canada Corp	MISSISSAUGA , CANADA	20-012-5321
Ashland Holdings B.V.	Barendrecht , NETHERLANDS	40-545-0417
ASK CHEMICALS JAPAN CO. LTD.	YOKOHAMA , JAPAN	69-096-4390
Ara Quimica S/A.	ARACARIGUAMA , BRAZIL	90-118-6619

Predictive Scores

Currency: Shown in USD unless otherwise indicated

Credit Capacity Summary

This credit rating was assigned because of D&Bs assessment of the companys creditworthiness. For more information, see the D&B Rating Key

D&B Rating : **ERN**

Number of employees: Not Available

Certain lines of business, primarily banks, insurance companies and government entities, do not lend themselves to classification under the D&B Rating system. Instead, we assign these types of businesses an Employee Range symbol based on the number of people employed. No other significance should be attached to this symbol. The ERN should not be interpreted negatively. It simply means we do not have information indicating how many people are employed at this firm.

Below is an overview of the companys rating history since 11-27-1996

Number of Employees Total: undetermined

D&B Rating	Date Applied
ERN	04-11-2000
ER8	11-27-1996

D&B Credit Limit Recommendation

Conservative credit Limit	750
Aggressive credit Limit:	2,500

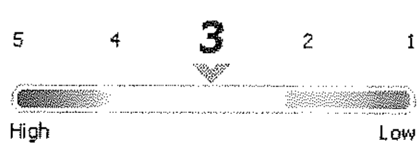
Risk category for this business : **MODERATE**

The Credit Limit Recommendation (CLR) is intended to serve as a directional benchmark for all businesses within the same line of business or industry, and is not calculated based on any individual business. Thus, the CLR is intended to help guide the credit limit decision, and must be balanced in combination with other elements which reflect the individual companys size, financial strength, payment history, and credit worthiness, all of which can be derived from D&B reports.
Risk is assessed using D&Bs scoring methodology and is one factor used to create the recommended limits. See Help for details.

Financial Stress Class Summary

The Financial Stress Score predicts the likelihood of a firm ceasing business without paying all creditors in full, or reorganization or obtaining relief from creditors under state/federal law over the next 12 months. Scores were calculated using a statistically valid model derived from D&Bs extensive data files.
The Financial Stress Class of 3 for this company shows that firms with this class had a failure rate of 0.24% (24 per 10,000), which is lower than the average of businesses in D & B's database

Financial Stress Class :



Moderate risk of severe financial stress, such as a bankruptcy, over the next 12 months.

Probability of Failure:

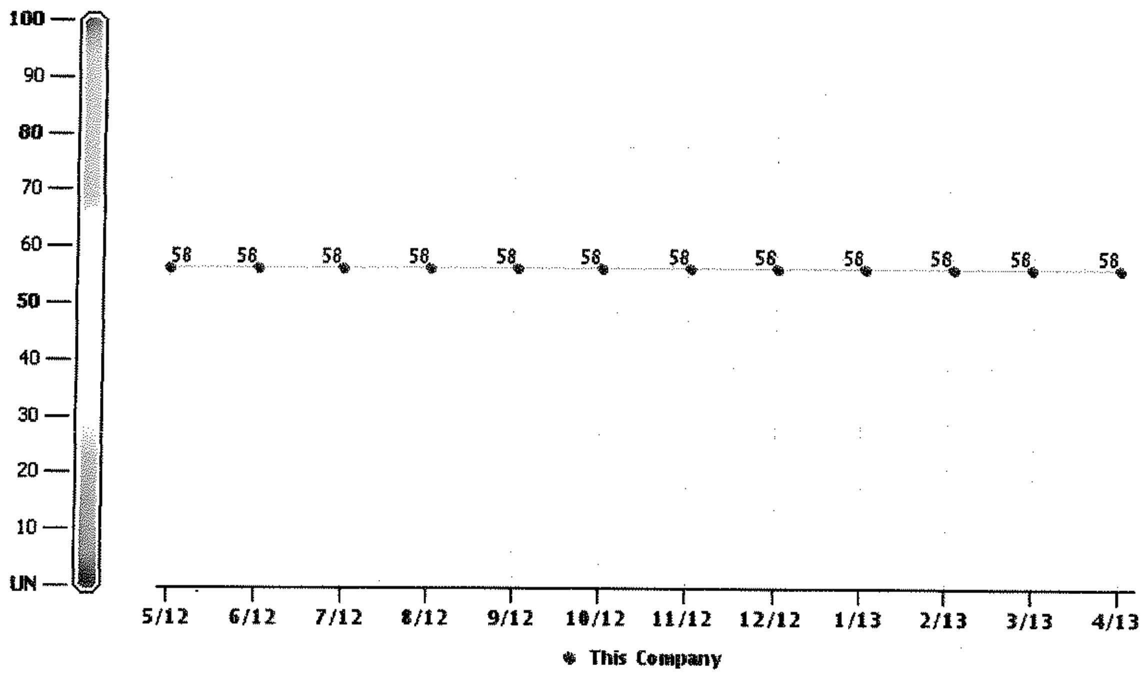
Among Businesses with this Class: **0.24 %** (24 per 10,000)
Financial Stress National Percentile : **58** (Highest Risk: 1; Lowest Risk: 100)
Financial Stress Score : **1490** (Highest Risk: 1,001; Lowest Risk: 1,875)

Average of Businesses in D&Bs database: **0.48 %** (48 per 10,000)

The Financial Stress Class of this business is based on the following factors:

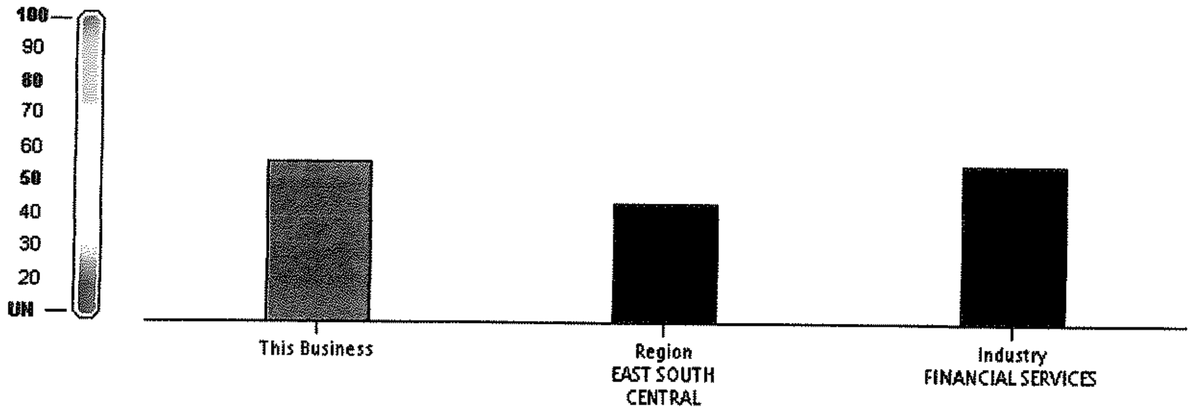
No payment experiences.

Financial Stress Percentile Trend:



Notes:

The Financial Stress Class indicates that this firm shares some of the same business and financial characteristics of other companies with this classification. It does not mean the firm will necessarily experience financial stress.
The Probability of Failure shows the percentage of firms in a given Class that discontinued operations over the past year with loss to creditors. The Probability of Failure - National Average represents the national failure rate and is provided for comparative purposes.
The Financial Stress National Percentile reflects the relative ranking of a company among all scorable companies in D&Bs file.
The Financial Stress Score offers a more precise measure of the level of risk than the Class and Percentile. It is especially helpful to customers using a scorecard approach to determining overall business performance.



Norms	National %
This Business	58
Region: EAST SOUTH CENTRAL	43
Industry: FINANCIAL SERVICES	57
Employee range:	UN
Years in Business: 26+	77

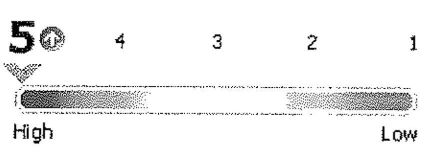
This Business has a Financial Stress Percentile that shows:

- Lower risk than other companies in the same region.
- Lower risk than other companies in the same industry.
- Higher risk than other companies with a comparable number of years in business.

Credit Score Summary

The Commercial Credit Score predicts the likelihood that a company will pay its bills in a severely delinquent manner (90 days or more past terms), obtain legal relief from creditors or cease operations without paying all creditors in full over the next 12 months. Scores are calculated using a statistically valid model derived from D&B's extensive data files.
The Credit Score class of 5 for this company shows that 70.0% of firms with this class paid one or more bills severely delinquent, which is 2.98 times higher than the average of businesses in D & B's database.

Credit Score Class :



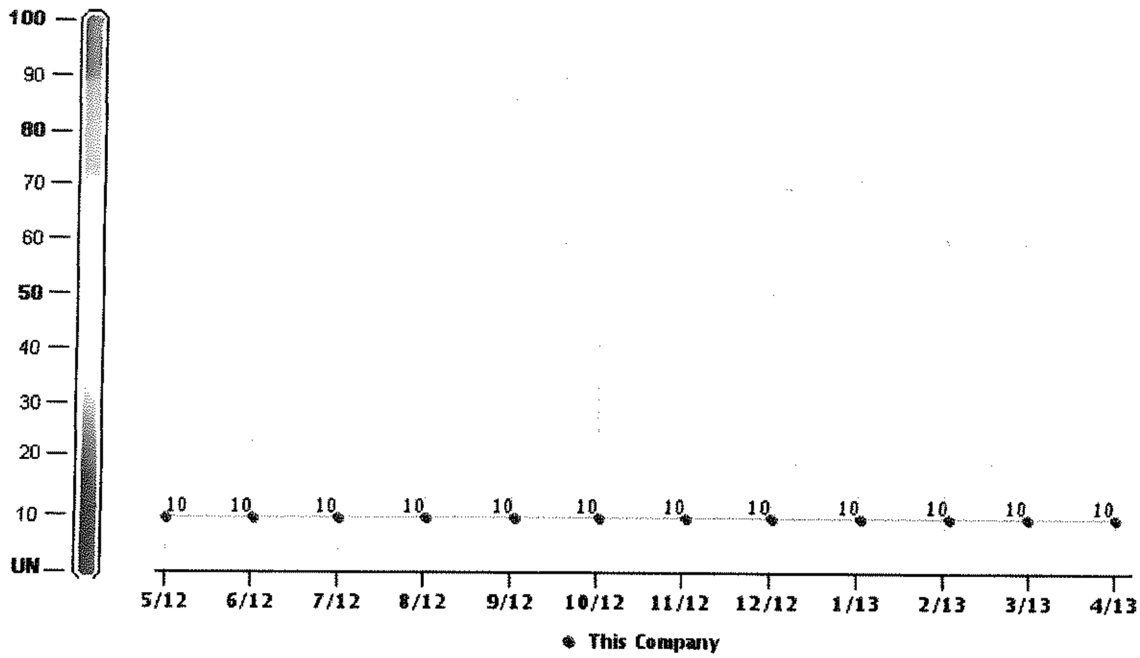
Incidence of Delinquent Payment

Among Companies with this Classification: **70.00 %**
Average compared to businesses in D&Bs database: **23.50 %**
Credit Score Percentile : **10** (Highest Risk: 1; Lowest Risk: 100)
Credit Score : **340** (Highest Risk: 101; Lowest Risk:670)

The Credit Score Class of this business is based on the following factors:

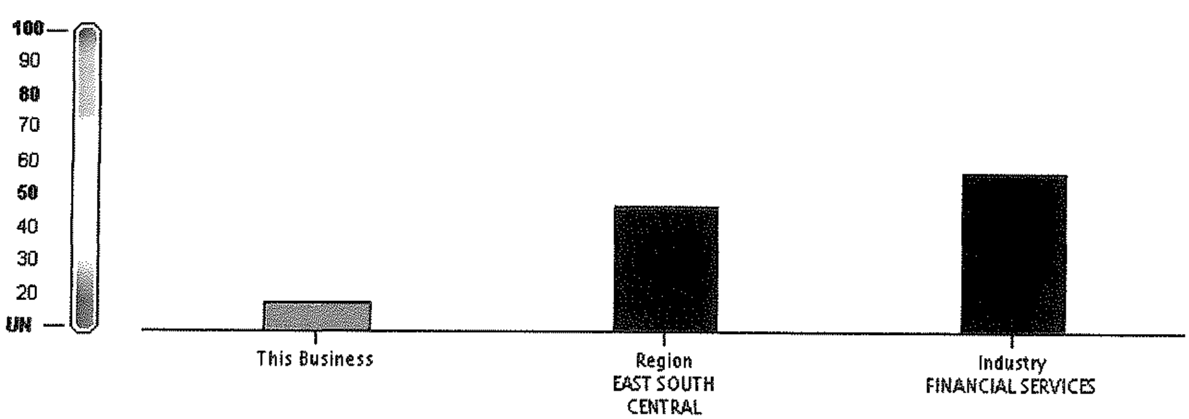
No payment experiences.

Credit Score Class Percentile Trend:



Notes:

The Commercial Credit Score Risk Class indicates that this firm shares some of the same business and financial characteristics of other companies with this classification. It does not mean the firm will necessarily experience severe delinquency.
The incidence of delinquency shows the percentage of firms in a given percentile that are likely to pay creditors in a severely delinquent manner. The average incidence of delinquency is based on businesses in D&B's database and is provided for comparative purposes.
The Commercial Credit Score percentile reflects the relative ranking of a firm among all scorable companies in D&B's file.
The Commercial Credit Score offers a more precise measure of the level of risk than the Risk Class and Percentile. It is especially helpful to customers using a scorecard approach to determining overall business performance.



Norms	National %

This Business	10
Region: EAST SOUTH CENTRAL	45
Industry: FINANCIAL SERVICES	57
Employee range:	UN
Years in Business: 26+	88

This business has a Credit Score Percentile that shows:

- Higher risk than other companies in the same region.
- Higher risk than other companies in the same industry.
- Higher risk than other companies with a comparable number of years in business.

Trade Payments

Currency: Shown in USD unless otherwise indicated

D&B PAYDEX®

Timeliness of historical payments for this company.

Current PAYDEX is		Unavailable
Industry Median is	**80**	Equal to generally within terms
Payment Trend currently is		Unavailable, compared to payments three months ago

Indications of slowness can be the result of dispute over merchandise, skipped invoices etc. Accounts are sometimes placed for collection even though the existence or amount of the debt is disputed.

Total payment Experiences in D&Bs File (HQ)	N/A
Payments Within Terms (not weighted)	N/A
Trade Experiences with Slow or Negative Payments(%)	N/A
Total Placed For Collection	N/A
High Credit Average	N/A
Largest High Credit	N/A
Highest Now Owing	N/A
Highest Past Due	N/A

D&B has not received a sufficient sample of payment experiences to establish a PAYDEX score.D&B receives nearly 400 million payment experiences each year. We enter these new and updated experiences into D&B Reports as this information is received. At this time, none of those experiences relate to this company.

Payment Habits

For all payment experiences within a given amount of credit extended, shows the percent that this Business paid within terms. Provides number of experiences to calculate the percentage, and the total credit value of the credit extended.

$ Credit Extended	**# Payment Experiences**	**Total Amount**	**% of Payments Within Terms**
Over 100,000	0	0	0%
50,000-100,000	0	0	0%

15,000-49,999	0	0	0%
5,000-14,999	0	0	0%
1,000-4,999	0	0	0%
Under 1,000	0	0	0%

Based on payments collected over last 24 months.
All Payment experiences reflect how bills are paid in relation to the terms granted. In some instances, payment beyond terms can be the result of disputes over merchandise, skipped invoices etc.

Detailed payment history for this company

D&B has not received a sufficient sample of payment experiences to establish a PAYDEX score.D&B receives nearly 400 million payment experiences each year. We enter these new and updated experiences into D&B Reports as this information is received. At this time, none of those experiences relate to this company.

Public Filings

Currency: Shown in USD unless otherwise indicated

Summary

A check of D&B's public records database indicates that no filings were found for ASHLAND INTERNATIONAL HOLDINGS INC at 1000 Ashland Dr, Russell KY.

D&B's extensive database of public record information is updated daily to ensure timely reporting of changes and additions. It includes business-related suits, liens, judgments, bankruptcies, UCC financing statements and business registrations from every state and the District of Columbia, as well as select filing types from Puerto Rico and the U.S. Virgin Islands.

D&B collects public records through a combination of court reporters, third parties and direct electronic links with federal and local authorities. Its database of U.S. business-related filings is now the largest of its kind.

History & Operations

Currency: Shown in USD unless otherwise indicated

Company Overview

Company Name:	ASHLAND INTERNATIONAL HOLDINGS INC
Doing Business As :	(SUBSIDIARY OF ASHLAND INC., COVINGTON, KY)
Street Address:	1000 Ashland Dr Russell, KY 41169
Phone:	606 329-3333
URL:	http://www.ashland.com
History	Is clear
Present management control	38 years

History

The following information was reported: **04/23/2008**

Officer(s):	PAUL SHELLGREN, V PRES
DIRECTOR(S) :	THE OFFICER(S)

The business was qualified in Kentucky on Dec 10 1992.

Business started 1975 by the parent company. 100% of capital stock is owned by the parent company.

PAUL SHELLGREN. Work history unknown.

Business Registration

CORPORATE AND BUSINESS REGISTRATIONS PROVIDED BY MANAGEMENT OR OTHER SOURCE
The Corporate Details provided below may have been submitted by the management of the subject business and may not have been verified with the government agency which records such data.

Registered Name:	ASHLAND INTERNATIONAL HOLDINGS INC
Business type:	CORPORATION
Corporation type:	PROFIT
Date incorporated:	Feb 27 1975
State of incorporation:	DELAWARE
Filing date:	Feb 27 1975
Where filed:	SECRETARY OF STATE/CORPORATIONS DIVISION , DOVER , DE

Operations

04/23/2008

Description:

Subsidiary of ASHLAND INC., COVINGTON, KY started 1936 which operates as a petroleum refining company and manufactures chemicals. Parent company owns 100% of capital stock. Parent company has numerous other subsidiary(ies). Intercompany relations: Undetermined.

As noted, this company is a subsidiary of Ashland Inc, DUNS number 005003264, and reference is made to that report for background information on the parent company and its management.

Active as a holding company, holding investments in related Ashland entities abroad (100%).

Territory : Local.

Employees:	undetermined which includes officer(s). The company has no employees.
Facilities:	Occupies premises in building.
Location:	Industrial section on side street.

SIC & NAICS

SIC:
Based on information in our file, D&B has assigned this company an extended 8-digit SIC. D&B's use of 8-digit SICs enables us to be more specific about a company's operations than if we use the standard 4-digit code.
The 4-digit SIC numbers link to the description on the Occupational Safety & Health Administration (OSHA) Web site. Links open in a new browser window.
6799 0000 Investors, nec
NAICS:

523910 Miscellaneous Intermediation

Financials

Currency: Shown in USD unless otherwise indicated

Company Financials: D&B

Additional Financial Data

Repeated attempts to contact business were unsuccessful.

Key Business Ratios

Business ratios are not available for this company or its industry. Certain segments, such as financial services, insurance companies, government agencies and public institutions, have distinctive financial reporting characteristics that do not allow for calculation of these measures.

EXHIBIT C

Courtesy Copy

Joseph Patella, Esq.
ANDREWS KURTH LLP
450 Lexington Avenue, 15th Floor,
New York, New York 10017
Tel: 609.716.6500
Fax: 609.799.7000

Thomas E. Starnes, Esq.
Charles M. Crout, Esq.
ANDREWS KURTH LLP
1350 I Street NW
Suite 1100
Washington, DC 20005
Tel: 202.662.2700
Fax: 202.662.2739

SUPERIOR COURT OF NEW JERSEY
LAW DIVISION
ESSEX VICINAGE
FEB - 4 2009
FINANCE DIVISION
RECEIVED/FILED
17

NEW JERSEY DEPARTMENT OF ENVIRONMENTAL PROTECTION, THE COMMISSIONER OF THE NEW JERSEY ENVIRONMENTAL PROTECTION AGENCY, and THE ADMINISTRATOR OF THE NEW JERSEY SPILL COMPENSATION FUND, Plaintiffs, vs. OCCIDENTAL CHEMICAL CORPORATION, TIERRA SOLUTIONS, INC., MAXUS ENERGY CORPORATION, REPSOL YPF, S.A., YPF, S.A., YPF HOLDINGS, INC. and CLH HOLDINGS, Defendants, MAXUS ENERGY CORPORATION and TIERRA SOLUTIONS, INC., Third-Party Plaintiffs, vs. 3M COMPANY, A.C.C., INC., ACH FOOD COMPANIES, INC., ACTIVE OIL SERVICE, ADCO CHEMICAL COMPANY, AGC CHEMICALS AMERICAS, INC.,	SUPERIOR COURT OF NEW JERSEY LAW DIVISION - ESSEX COUNTY DOCKET NO. L-009868-05

ALDEN-LEEDS, INC.,
ALLIANCE CHEMICAL, INC.,
ALUMAX MILL PRODUCTS, INC.,
AMCOL REALTY CO.,
AMERICAN INKS AND COATINGS CORPORATION,
APEXICAL, INC.,
APOLAN INTERNATIONAL, INC.,
ARKEMA, INC.,
ASHLAND INC.,
ASHLAND INTERNATIONAL HOLDINGS, INC.,
ASSOCIATED AUTO BODY & TRUCKS, INC.,
ATLAS REFINERY, INC.,
AUTOMATIC ELECTRO-PLATING CORP.,
AKZO NOBEL COATINGS, INC.,
BASF CATALYSTS LLC,
BASF CONSTRUCTION CHEMICALS INC.,
BASF CORPORATION,
BAYER CORPORATION,
BEAZER EAST, INC.,
BELLEVILLE INDUSTRIAL CENTER,
BENJAMIN MOORE & COMPANY,
BEROL CORPORATION,
B-LINE TRUCKING, INC.,
BORDEN & REMINGTON CORP.,
C.S. OSBORNE & CO.,
CAMPBELL FOUNDRY COMPANY,
CASCHEM, INC.,
CBS CORPORATION,
CELANESE LTD.,
CHEMICAL COMPOUNDS INC.,
CHEMTURA CORPORATION,
CLEAN EARTH OF NORTH JERSEY, INC.,
COSMOPOLITAN GRAPHICS CORPORATION,
CIBA CORPORATION,
COLTEC INDUSTRIES INC.,
COLUMBIA TERMINALS, INC.,
COMO TEXTILE PRINTS, INC.,
CONAGRA PANAMA, INC.;
CONOPCO, INC.,
CONSOLIDATED RAIL CORPORATION,
COOK & DUNN PAINT CORPORATION,
COSAN CHEMICAL CORPORATION,
COVANTA ESSEX COMPANY,
CRODA, INC.,
CRUCIBLE MATERIALS CORPORATION,
CURTISS-WRIGHT CORPORATION,
CWC INDUSTRIES, INC.,
DARLING INTERNATIONAL, INC.,
DAVANNE REALTY CO.,
DELEET MERCHANDISING CORPORATION,
DELVAL INK AND COLOR, INCORPORATED,

DILORENZO PROPERTIES COMPANY, L.P.,
E.I. DU PONT DE NEMOURS AND COMPANY,
EASTMAN KODAK COMPANY,
EDEN WOOD CORPORATION,
ELAN CHEMICAL COMPANY, INC.,
EM SERGEANT PULP & CHEMICAL CO.,
EMERALD HILTON DAVIS, LLC,
ESSEX CHEMICAL CORPORATION,
EXXON MOBIL
F.E.R. PLATING, INC.,
FINE ORGANICS CORPORATION,
FISKE BROTHERS REFINING COMPANY,
FLEXON INDUSTRIES CORPORATION,
FLINT GROUP INCORPORATED,
FORT JAMES CORPORATION,
FOUNDRY STREET CORPORATION,
FRANKLIN-BURLINGTON PLASTICS, INC.,
GARFIELD MOLDING COMPANY, INC.,
GENERAL CABLE INDUSTRIES, INC.;
GENERAL DYNAMICS CORPORATION,
GENERAL ELECTRIC COMPANY,
GENTEK HOLDING LLC,
GIVAUDAN FRAGRANCES CORPORATION,
G. J. CHEMICAL CO.,
GOODY PRODUCTS, INC.,
GORDON TERMINAL SERVICE CO. OF N.J., INC.,
HARRISON SUPPLY COMPANY,
HARTZ MOUNTAIN CORPORATION,
HAVENICK ASSOCIATES L.P.,
HEXCEL CORPORATION,
HEXION SPECIALTY CHEMICALS, INC.,
HOFFMANN-LA ROCHE INC.,
HONEYWELL INTERNATIONAL INC.,
HOUGHTON INTERNATIONAL INC.,
HUDSON TOOL & DIE COMPANY, INC,
HY-GRADE ELECTROPLATING CO.,
ICI AMERICAS INC.,
INNOSPEC ACTIVE CHEMICALS LLC,
INX INTERNATIONAL INK CO.,
ISP CHEMICALS INC.,
ITT CORPORATION,
KEARNY SMELTING & REFINING CORP.,
KAO BRANDS COMPANY,
KOEHLER-BRIGHT STAR, INC.,
LINDE, INC.,
LUCENT TECHNOLOGIES, INC.,
MACE ADHESIVES & COATINGS COMPANY, INC.,
MALLINCKRODT INC.,
MERCK & CO., INC.,
METAL MANAGEMENT NORTHEAST, INC.,
MI HOLDINGS, INC.,

MILLER ENVIRONMENTAL GROUP, INC.,
MORTON INTERNATIONAL, INC.,
N L INDUSTRIES, INC.,
NAPPWOOD LAND CORPORATION,
NATIONAL FUEL OIL, INC.,
NATIONAL-STANDARD, LLC,
NELL-JOY INDUSTRIES, INC.,
NESTLE U.S.A., INC.,
NEW JERSEY TRANSIT CORPORATION,
NEWS AMERICA, INC.,
NEWS PUBLISHING AUSTRALIA LIMITED,
NORPAK CORPORATION,
NOVELIS CORPORATION,
ORANGE AND ROCKLAND UTILITIES, INC.,
OTIS ELEVATOR COMPANY,
PRC-DESOTO INTERNATIONAL, INC.,
PASSAIC PIONEERS PROPERTIES COMPANY,
PFIZER INC.,
PHARMACIA CORPORATION,
PHELPS DODGE INDUSTRIES, INC.,
PHILBRO, INC.,
PITT-CONSOL CHEMICAL COMPANY,
PIVOTAL UTILITY HOLDINGS, INC.,
PPG INDUSTRIES, INC.,
PRC-DESOTO INTERNATIONAL, INC.,
PRAXAIR, INC.,
PRECISION MANUFACTURING GROUP, LLC,
PRENTISS INCORPORATED,
PROCTER & GAMBLE MANUFACTURING COMPANY,
PRYSMIAN COMMUNICATIONS CABLES AND
SYSTEMS USA LLC,
PSEG FOSSIL LLC,
PUBLIC SERVICE ELECTRIC AND GAS COMPANY,
PURDUE PHARMA TECHNOLOGIES, INC.,
QUALA SYSTEMS, INC.,
QUALITY CARRIERS, INC.,
RECKITT BENCKISER, INC.,
REICHHOLD, INC.,
REVERE SMELTING & REFINING CORPORATION,
REXAM BEVERAGE CAN COMPANY,
ROMAN ASPHALT CORPORATION,
ROYCE ASSOCIATES, A LIMITED PARTNERSHIP,
R.T. VANDERBILT COMPANY, INC.,
RUTHERFORD CHEMICALS LLC,
S&A REALTY ASSOCIATES, INC.,
SCHERING CORPORATION,
SEQUA CORPORATION,
SETON COMPANY,
SIEMENS WATER TECHNOLOGIES CORP.
SINGER SEWING COMPANY
SPECTRASERV, INC.,

STWB, INC.,
SUN CHEMICAL CORPORATION,
SVP WORLDWIDE, LLC,
TATE & LYLE INGREDIENTS AMERICAS, INC.,
TEVA PHARMACEUTICALS USA, INC.,
TEVAL CORP.,
TEXTRON INC.,
THE DIAL CORPORATION,
THE DUNDEE WATER POWER AND LAND COMPANY,
THE NEWARK GROUP, INC.,
THE OKONITE COMPANY, INC.,
THE SHERWIN-WILLIAMS COMPANY,
THE STANLEY WORKS,
THE VALSPAR CORPRATION,
THIRTY-THREE QUEEN REALTY INC.,
THREE COUNTY VOLKSWAGEN CORPORATION,
TIDEWATER BALING CORP.,
TIFFANY & CO.,
TIMCO, INC.,
TRIMAX BUILDING PRODUCTS, INC.,
TROY CHEMICAL CORPORATION, INC.,
UNIVERSAL OIL PRODUCTS COMPANY,
V. OTTILIO & SONS, INC.,
VELSICOL CHEMICAL CORPORATION,
VEOLIA ES TECHNICAL SOLUTIONS, L.L.C.,
VERTELLUS SPECIALTIES INC.,
VITUSA CORP.,
VULCAN MATERIALS COMPANY,
W.A.S. TERMINALS CORPORATION,
W.A.S. TERMINALS, INC.,
W.C. INDUSTRIES,
WHITTAKER CORPORATION,
WIGGINS PLASTICS, INC.,
ZENECA INC.,

Third-Party Defendants.

MAXUS ENERGY CORPORATION'S AND TIERRA SOLUTIONS, INC.'S

THIRD-PARTY COMPLAINT "B"

Defendants Maxus Energy Corporation ("Maxus") and Tierra Solutions, Inc. ("Tierra") bring this Third-Party Complaint against the herein named Third-Party Defendants, and allege as follows:

storm sewer catch basin and a spill outside of a boiler room at the Universal Oil Products Site were also observed during the July 1979 inspection.

2908. A seep/sewer investigation at the Universal Oil Products Site determined that Hazardous Substances were present in the on-site sewer system and were discharging to Ackerman's Creek. Hazardous Substances and other compounds detected in the storm sewer system on the Universal Oil Products Site include: benzene, 1,2-dichloroethene, vinyl chloride, trichloroethene toluene, chlorobenzene, ethylbenzene, xylenes, 1,4-dichlorobenzene, PCBs, arsenic, cadmium, chromium, copper, lead, mercury, nickel, and zinc.

2909. The storm sewer at the Universal Oil Products Site was hydraulically connected to Ackerman's creek.

2910. In 1997, AlliedSignal Inc. reported that it had exceeded the discharge permit for aroclor-1248 (a PCB) in the effluent stream from a temporary water treatment plant at the Universal Oil Products Site.

2911. Hazardous Substances from the Universal Oil Products Site were discharged into Berry's Creek. Numerous Hazardous Substances, including chlorobenzene, mercury, chromium, and PCBs have been detected in the sediment of Berry's Creek.

2912. The Universal Oil Products Site was placed on the National Priorities List of Superfund in 1983.

2913. UOP and/or Honeywell are "dischargers" and/or Persons "in any way responsible" for the Hazardous Substances that were discharged at the Universal Oil Products Site and released into the Newark Bay Complex.

Van Dyk Site

2914. The Van Dyk & Company property consists of real property and associated improvements located at 11 William Street in Belleville, Essex County, New Jersey, also designated as Block 12, Lots 3, 17, 18, 25, 29, 30, and 32, and Block 8, Lot 24 on the Tax Map of the City of Belleville ("Van Dyk Site").

2915. The Van Dyk Site lies approximately 250 feet east-southeast of the Passaic River. From the Van Dyk Site, stormwater runoff and direct discharges of liquids flowed into floor drains, which discharged into PVSC sanitary sewer lines, or into area storm drains, which emptied into the main storm sewer line beneath Main Street and William Street, and which discharges directly into the Passaic River.

2916. From approximately 1943 until approximately 1982, Van Dyk & Company, Inc., a closely-held New Jersey corporation also known as Van Dyk Inc. or Van Dyk & Co. (collectively "Van Dyk"), owned and operated a cosmetic chemical manufacturing facility at the Van Dyk Site

2917. In 1982, Mallinckrodt, Inc. ("Mallinckrodt"), a Missouri corporation was acquired by and became a wholly-owned subsidiary of Avon Products, Inc. ("Avon"), a New York corporation. At approximately the same time, Mallinckrodt acquired the outstanding stock and assets of Van Dyk. Van Dyk was ultimately merged into and operated as a division of Mallinckrodt, which continued to operate a cosmetic and specialty chemical manufacturing facility at the Van Dyk Site. Avon Capital Corporation, a Delaware corporation and wholly-owned subsidiary of Avon, owned the real property at the Van Dyk Site until May 1986.

2918. In 1986, Avon sold certain capital stock of Mallinckrodt and assets, including the Van Dyk division, to International Minerals and Chemical Corporation, a New York corporation ("IMCC"). Upon information and belief, Mallinckrodt was then reincorporated as a Delaware corporation and operated as a wholly-owned subsidiary of IMCC. Mallinckrodt continued cosmetic and specialty chemical manufacturing operations at the Van Dyk Site and continued to operate the Van Dyk operations as a division of Mallinckrodt until approximately 1992.

2919. Upon information and belief, in 1992, International Specialty Products, Inc. acquired the fixed and operating assets of the Van Dyk division of Mallinckrodt, including the Van Dyk Site. The Van Dyk Site and operations were owned and operated through a wholly-owned subsidiary known as ISP Van Dyk Inc., a Delaware corporation that was incorporated on or about March 23, 1992. On or about June 30, 2001, ISP Van Dyk Inc. was merged with and into ISP Chemicals Inc. ("ISP Chemicals"), the sole surviving entity. ISP Chemicals is a wholly-owned indirect subsidiary of International Specialty Products, Inc.

2920. Upon information and belief, ISP Chemicals is the current successor to Van Dyk and, therefore, succeeds to Van Dyk's environmental liabilities related to the Van Dyk Site.

2921. Chemicals manufactured at the Van Dyk Site, include, but are not limited to, component ingredients for use in sunscreens, assorted emulsifiers, emollients, emulsifiers, esters, conditioners, and other chemical intermediates.

2922. Van Dyk's operations utilized reaction vessels, which were heated with PCB-laden oils. Other Hazardous Substances and chemicals ISP or its predecessors processed, handled, mixed, manufactured, consumed, stored, or otherwise used at the Van Dyk Site, include, but are not limited to, formaldehyde, sulfuric acid, hydrochloric acid, potassium hydroxide, toluene, acetone, methanol, mercury, chloroform, fuel oil, petroleum hydrocarbons, silver nitrate, tetrahydrofuran, and iodine.

2923. On or about November 17, 1948, a section of an oil-intake pipe, which was located near the bank of the Passaic River, was removed by Van Dyk and oil drained from the pipe into the Passaic River.

2924. On or about August 16, 1956, a fire and explosion occurred at the Van Dyk Site. Water, foam, and contaminated runoff from the fire fighting efforts drained from the Van Dyk Site into an area stormwater catch basin, which emptied into the Passaic River. Upon information and belief, flow from the catch basin discharged into the Passaic River.

2925. On or about April 20, 1977, a six-inch sanitary sewer line on the Van Dyk Site overflowed and wastewater effluent flowed into an on-site stormwater catch basin. Upon information and belief, the stormwater catch basin ultimately discharged into the Passaic River. Upon information and belief, the wastewater effluent contained Hazardous Substances.

2926. On or about April 13, 1988, the PVSC issued a citation to the Van Dyk Site for discharging flammable liquids into the PVSC sanitary sewer system in excess of permitted limits.

2927. On or about June 18, 1993, approximately 100 gallons of waste solvent effluent was released from the Van Dyk Site into a storm sewer adjacent to the facility near the corner of Main and Williams Streets. The storm sewer discharged directly to the Passaic River. The effluent contained Hazardous Substances and other substances including, but not limited to, toluene, ethanol, methanol, butyl alcohol, 2 ethyl hexanol, ethyl hexyl acetate, and other non-volatile residues. ISP officials estimated that up to 55-gallons of the effluent discharged into the Passaic River. Furthermore, firefighters used approximately 25,000 gallons of water to flush the storm sewer line and dilute the effluent in the Passaic River.

2928. On or about June 23, 1995, a sanitary sewer line on the Van Dyk Site overflowed and approximately 200 gallons of wastewater effluent flowed into an on-site stormwater catch basin, entered a storm sewer beneath Main Street, and ultimately discharged into the Passaic River. Upon information and belief, the wastewater effluent contained Hazardous Substances. After the discharge, ISP officials reportedly jet washed the storm sewer lines.

2929. On or about April 12, 1996, approximately 10-20 gallons of waste solvent effluent was discharged from the Van Dyk Site into a storm sewer and thence into the Passaic River. ISP reported that at least one quart of effluent entered the storm sewer system. The effluent contained Hazardous Substances and other substances including, but not limited to, toluene, butyl alcohol, ethyl hexyl acetate, and other non-volatile residues.

2930. Soil samples taken at the Van Dyk Site confirmed the presence of Hazardous Substances and other substances, including, but not limited to, mercury, PCBs, petroleum hydrocarbons, assorted base neutral compounds, and various volatile organic chemicals.

2931. Groundwater samples taken at the Van Dyk Site confirmed the presence of Hazardous Substances and other substances, including, but not limited to, mercury, PCBs, various volatile organic chemicals, toluene, benzene, ethylbenzene, naphthalene, assorted base neutral compounds, chloroform, petroleum hydrocarbons, bis(2-ethylehexyl)phthalate, and di-n-butyl phthalate.

2932. Upon information and belief, spills, leaks, mechanical failures, and poor housekeeping practices resulted in Discharges of Hazardous Substances to and from the Van Dyk Site.

2933. On or about June 8, 2006, EPA sent a General Notice Letter notifying ISP Chemicals, Inc. of its potential liability for Response costs relating to the Lower Passaic River Study Area as the result of the Release of Hazardous Substances from the Van Dyk Site.

2934. ISP Chemicals, as successor to Van Dyk, is a "discharger" and/or Person "in any way responsible" for the Hazardous Substances that were discharged at the Van Dyk Site and released into the Newark Bay Complex.

Ventron/Velsicol Site

2935. The Ventron/Velsicol property consists of approximately 40 acres of real property and associated improvements located in the Boroughs of Wood-Ridge and Carlstadt in Bergen County, New Jersey (the "Ventron/Velsicol Site"). The site is bordered by Berry's Creek to the east, which is a tributary of the Hackensack River.

2936. From 1929 to 1960, first as lessee and then as owner of the entire forty-acre Ventron/Velsicol Site, F.W. Berk and Company, Inc. ("Berk") operated a mercury processing plant, dumping untreated waste material and allowing mercury-laden effluent to drain on the site. Berk continued uninterrupted operations until 1960, at which time it sold its assets to Wood Ridge Chemical Corporation ("Wood Ridge") and ceased its corporate existence.

2937. In 1960, Velsicol Chemical Corporation ("Velsicol") formed Wood Ridge as a wholly-owned subsidiary for the sole purpose of purchasing Berk's assets and operating the mercury processing plant. In 1967, Wood Ridge subdivided the tract and declared a thirty-three-acre land dividend to Velsicol, which continued to permit Wood Ridge to dump contaminated material on the thirty-three acres. This dumping contaminated the land owned by Velsicol and Berry's Creek with mercury.

2938. As a Velsicol subsidiary, Wood Ridge continued to operate the processing plant on the 7.1-acre tract from 1960 to 1968, when Velsicol sold Wood Ridge to Ventron Corporation ("Ventron").

EXHIBIT D

DNBi®
Risk Management

Printed By: Patrick DiDomenico
Date Printed: April 15, 2013

Live Report : ISP CHEMICALS LLC

D-U-N-S® Number: 00-218-8894
Trade Names: (SUBSIDIARY OF ISP CHEMICALS INC., WAYNE, NJ)
Endorsement/Billing Reference: pdidomenico@gibbonslaw .com

D&B Address

Address	455 N Main St Calvert City,KY - 42029	**Location Type**	Headquarters (Subsidiary)
Phone	270 395-4165	**Web**	www.ispchemicals.com
Fax	270-395-1464		

Endorsement : pdidomenico@gibbonslaw.com

Company Summary

Currency: Shown in USD unless otherwise indicated

Score Bar

PAYDEX®	64
Commercial Credit Score Class	3
Financial Stress Score Class	5
Credit Limit - D&B Conservative	-
D&B Rating	--

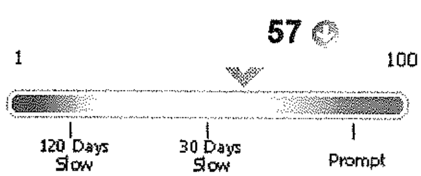
Company News

Today: Monday, April 15, 2013

This company is not currently tracked for Company News.

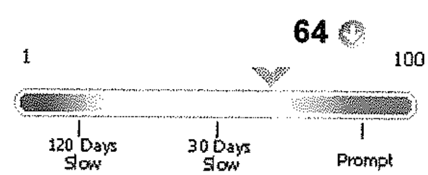
Powered by FirstRain

D&B 3-month PAYDEX®



When weighted by amount, Payments to suppliers average 25 Days Beyond Terms

D&B PAYDEX®



When weighted by amount, Payments to suppliers average 19 days beyond terms

D&B Company Overview

This is a headquarters (subsidiary) location

Branch(es) or Division(s) exist	Y
Mailing Address	PO BOX 37 CALVERT CITY,KY 42029
Manager	SUNIL KUMAR, MNG MBR
Year Started	2007
Employees	600 (UNDETERMINED Here)

Public Filings

The following data includes both open and closed filings found in D&B's database on this company.

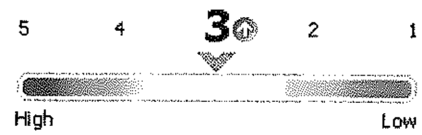
Record Type	Number of Records	Most Recent Filing Date

Financing	SECURED
SIC	2869
Line of business	Mfg industrial organic chemicals
NAICS	325199
History Status	CLEAR

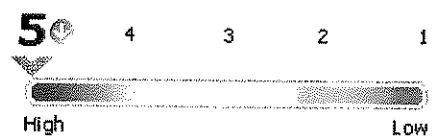
Bankruptcies	0	-
Judgments	0	-
Liens	1	08/03/01
Suits	0	-
UCCs	2	08/27/07

The public record items contained herein may have been paid, terminated, vacated or released prior to todays date.

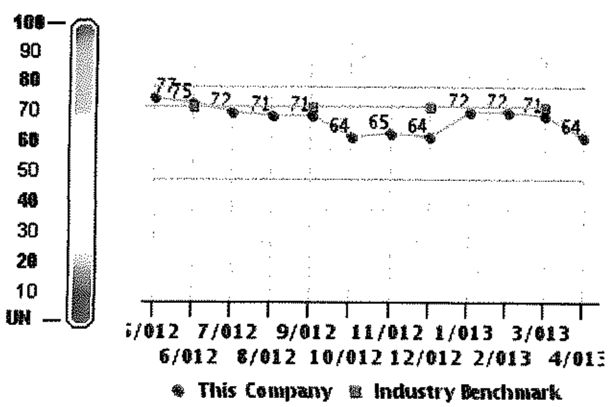
Commercial Credit Score Class



Financial Stress Score Class

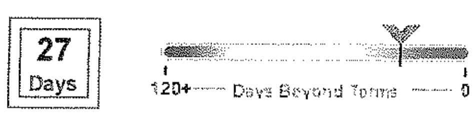


PAYDEX® Trend Chart



Detailed Trade Risk Insight™

Days Beyond Terms Past 3 Months

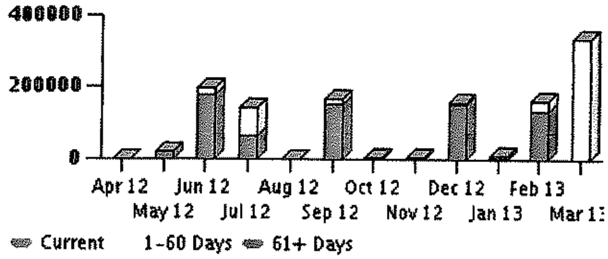


Dollar-weighted average of **6** payment experiences reported from **5** Companies

Recent Derogatory Events

	Jan-13	Feb-13	Mar-13
Placed for Collection	-	-	-
Bad Debt Written Off	-	-	-

Total Amount Current & Past Due - 12 Month Trend



Corporate Linkage

Domestic Ultimate

Company	City , State	D-U-N-S® NUMBER
ASHLAND INC.	COVINGTON , Kentucky	00-500-3264

Parent

Company	City , State	D-U-N-S® NUMBER
ISP CHEMICALS INC.	WAYNE , New Jersey	13-541-2869

Branches (Domestic)

Company	City , State	D-U-N-S® NUMBER
ISP CHEMICALS LLC	CHATHAM , New Jersey	95-670-5586
ISP CHEMICALS LLC	COLUMBUS , Ohio	07-841-3681

Affiliates (Domestic)

Company	City , State	D-U-N-S® NUMBER
ISP MINERALS INC.	PEMBINE , Wisconsin	10-693-0386
ISP MANAGEMENT COMPANY, INC.	WAYNE , New Jersey	78-534-5208
ISP TECHNOLOGIES INC.	WAYNE , New Jersey	79-831-5149

Predictive Scores

Currency: Shown in USD unless otherwise indicated

Credit Capacity Summary

This credit rating was assigned because of D&Bs assessment of the companys creditworthiness. For more information, see the D&B Rating Key

D&B Rating : --

The blank rating symbol should not be interpreted as indicating that credit should be denied. It simply means that the information available to D&B does not permit us to classify the company within our rating key and that further enquiry should be made before reaching a decision. Some reasons for using a "-" symbol include: deficit net worth, bankruptcy proceedings, insufficient payment information, or incomplete history information.

Below is an overview of the companys rating history since 01-01-1991

D&B Rating	Date Applied
--	01-10-2012
1R4	12-05-2011
--	08-25-2003
1R3	01-16-2001
1R4	10-27-2000
--	01-01-1991

Number of Employees Total: 600 (UNDETERMINED here)

Payment Activity:	(based on 51 experiences)
Average High Credit:	20,079
Highest Credit:	300,000
Total Highest Credit:	753,350

D&B Credit Limit Recommendation

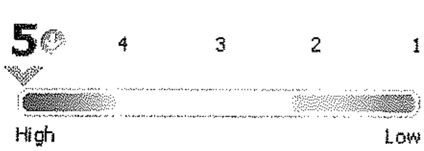
Due to adverse or incomplete information, we are unable to provide a Credit Limit Recommendation for this business. Please contact your sales representative or D&Bs Customer Resource Center at 800-234-3867 for assistance.

The Credit Limit Recommendation (CLR) is intended to serve as a directional benchmark for all businesses within the same line of business or industry, and is not calculated based on any individual business. Thus, the CLR is intended to help guide the credit limit decision, and must be balanced in combination with other elements which reflect the individual company's size, financial strength, payment history, and credit worthiness, all of which can be derived from D&B reports.
Risk is assessed using D&Bs scoring methodology and is one factor used to create the recommended limits. See Help for details.

Financial Stress Class Summary

The Financial Stress Score predicts the likelihood of a firm ceasing business without paying all creditors in full, or reorganization or obtaining relief from creditors under state/federal law over the next 12 months. Scores were calculated using a statistically valid model derived from D&Bs extensive data files.
The Financial Stress Class of 5 for this company shows that firms with this class had a failure rate of 4.7% (470 per 10,000), which is 9.79 times higher than the average of businesses in D & B's database.

Financial Stress Class :



High risk of of severe financial stress, such as a bankruptcy, over the next 12 months.

Probability of Failure:

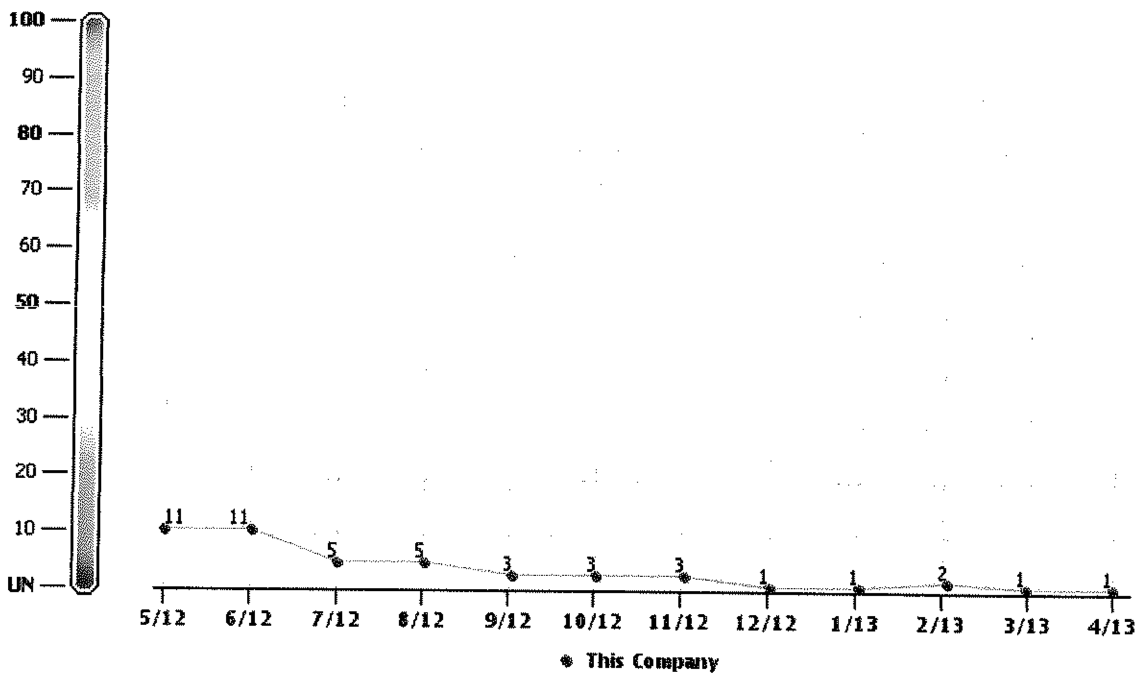
Among Businesses with this Class: **4.70 %** (470 per 10,000)
Financial Stress National Percentile : **1** (Highest Risk: 1; Lowest Risk: 100)
Financial Stress Score : **1328** (Highest Risk: 1,001; Lowest Risk: 1,875)

Average of Businesses in D&Bs database: **0.48 %** (48 per 10,000)

The Financial Stress Class of this business is based on the following factors:

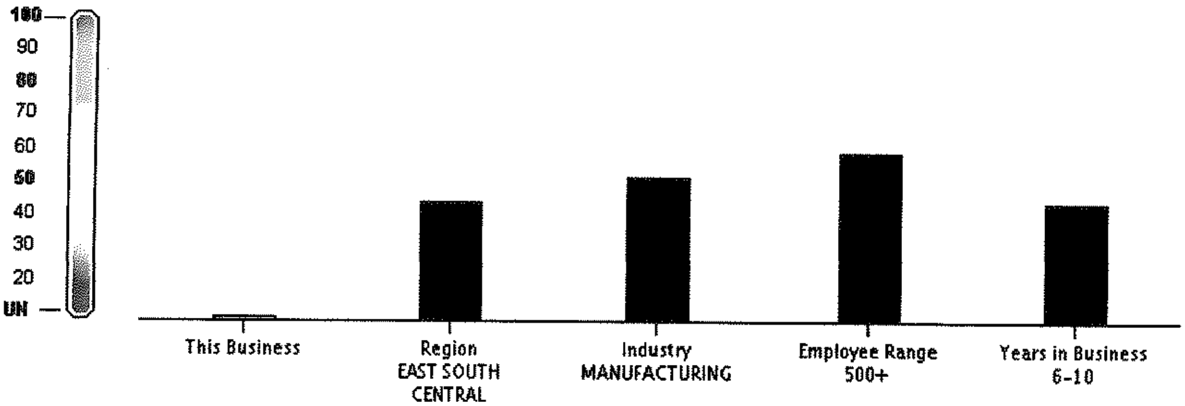
Low proportion of satisfactory payment experiences to total payment experiences.
UCC Filings reported.
High number of inquiries to D & B over last 12 months.
Evidence of open liens.
High proportion of slow payment experiences to total number of payment experiences.
High proportion of past due balances to total amount owing.

Financial Stress Percentile Trend:



Notes:

The Financial Stress Class indicates that this firm shares some of the same business and financial characteristics of other companies with this classification. It does not mean the firm will necessarily experience financial stress.
The Probability of Failure shows the percentage of firms in a given Class that discontinued operations over the past year with loss to creditors. The Probability of Failure - National Average represents the national failure rate and is provided for comparative purposes.
The Financial Stress National Percentile reflects the relative ranking of a company among all scorable companies in D&Bs file.
The Financial Stress Score offers a more precise measure of the level of risk than the Class and Percentile. It is especially helpful to customers using a scorecard approach to determining overall business performance.



Norms	National %
This Business	1
Region: EAST SOUTH CENTRAL	43
Industry: MANUFACTURING	52
Employee range: 500+	61
Years in Business: 6-10	43

This Business has a Financial Stress Percentile that shows:

- Higher risk than other companies in the same region.
- Higher risk than other companies in the same industry.
- Higher risk than other companies in the same employee size range.
- Higher risk than other companies with a comparable number of years in business.

Credit Score Summary

The Commercial Credit Score predicts the likelihood that a company will pay its bills in a severely delinquent manner (90 days or more past terms), obtain legal relief from creditors or cease operations without paying all creditors in full over the next 12 months. Scores are calculated using a statistically valid model derived from D&B's extensive data files.
The Credit Score class of 3 for this company shows that 18.4% of firms with this class paid one or more bills severely delinquent, which is lower than the average of businesses in D & B's database.

Credit Score Class :

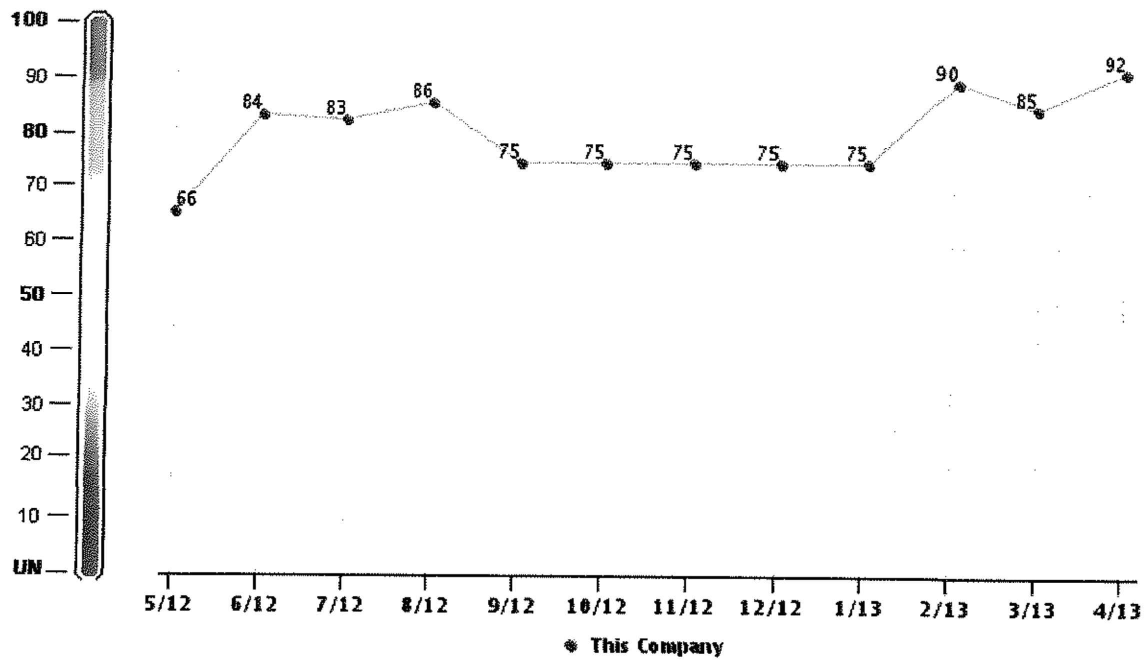
Incidence of Delinquent Payment

Among Companies with this Classification: **18.40 %**
Average compared to businesses in D&Bs database: **23.50 %**
Credit Score Percentile : **44** (Highest Risk: 1; Lowest Risk: 100)
Credit Score : **419** (Highest Risk: 101; Lowest Risk:670)

The Credit Score Class of this business is based on the following factors:

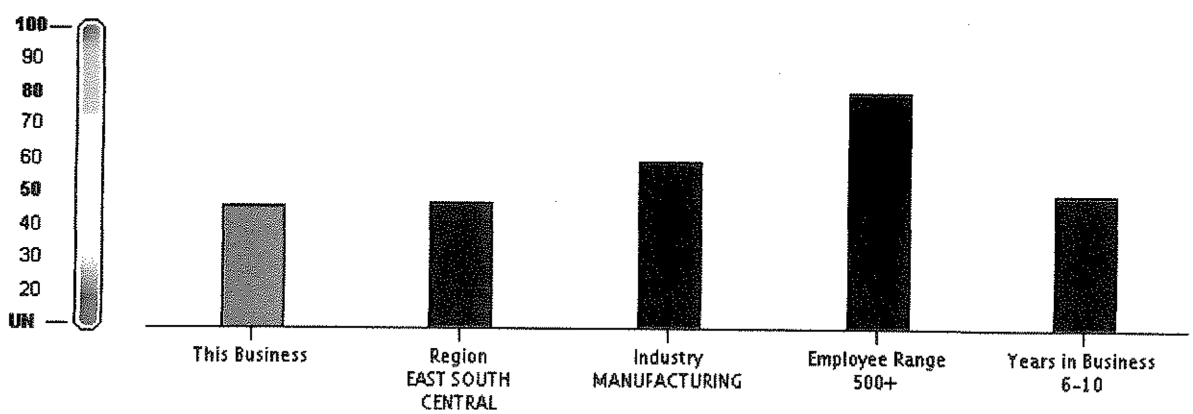
Most recent amount past due.
Insufficient number of payment experiences.
Low proportion of satisfactory payment experiences to total payment experiences.

Credit Score Class Percentile Trend:



Notes:

The Commercial Credit Score Risk Class indicates that this firm shares some of the same business and financial characteristics of other companies with this classification. It does not mean the firm will necessarily experience severe delinquency.
The incidence of delinquency shows the percentage of firms in a given percentile that are likely to pay creditors in a severely delinquent manner. The average incidence of delinquency is based on businesses in D&B's database and is provided for comparative purposes.
The Commercial Credit Score percentile reflects the relative ranking of a firm among all scorable companies in D&B's file.
The Commercial Credit Score offers a more precise measure of the level of risk than the Risk Class and Percentile. It is especially helpful to customers using a scorecard approach to determining overall business performance.



Norms	National %

This Business	44
Region: EAST SOUTH CENTRAL	45
Industry: MANUFACTURING	60
Employee range: 500+	85
Years in Business: 6-10	48

This business has a Credit Score Percentile that shows:

- Higher risk than other companies in the same region.
- Higher risk than other companies in the same industry.
- Higher risk than other companies in the same employee size range.
- Higher risk than other companies with a comparable number of years in business.

Trade Payments

Currency: Shown in USD unless otherwise indicated

D&B PAYDEX®

The D&B PAYDEX is a unique, weighted indicator of payment performance based on payment experiences as reported to D&B by trader references. Learn more about the D&B PAYDEX

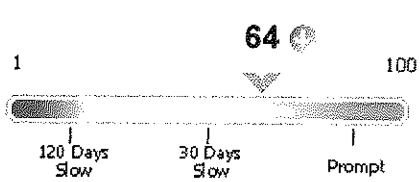
Timeliness of historical payments for this company.

Current PAYDEX is	**64**	Equal to 19 days beyond terms (Pays more slowly than the average for its industry of 9 days beyond terms)
Industry Median is	**74**	Equal to 9 days beyond terms
Payment Trend currently is		Down, compared to payments three months ago

Indications of slowness can be the result of dispute over merchandise, skipped invoices etc. Accounts are sometimes placed for collection even though the existence or amount of the debt is disputed.

Total payment Experiences in D&Bs File (HQ)	51
Payments Within Terms (not weighted)	70 %
Trade Experiences with Slow or Negative Payments(%)	31.37%
Total Placed For Collection	0
High Credit Average	20,079
Largest High Credit	300,000
Highest Now Owing	300,000
Highest Past Due	300,000

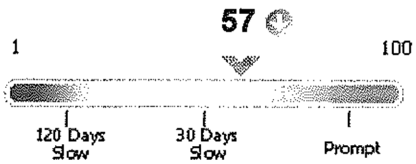
D&B PAYDEX



- High risk of late payment (Average 30 to 120 days beyond terms)
- Medium risk of late payment (Average 30 days or less beyond terms)
- Low risk of late payment (Average prompt to 30+ days sooner)

When weighted by amount, payments to suppliers average 19 days beyond terms

3-Month D&B PAYDEX



- High risk of late payment (Average 30 to 120 days beyond terms)
- Medium risk of late payment (Average 30 days or less beyond terms)
- Low risk of late payment (Average prompt to 30+ days sooner)

Based on payments collected over last 3 months.

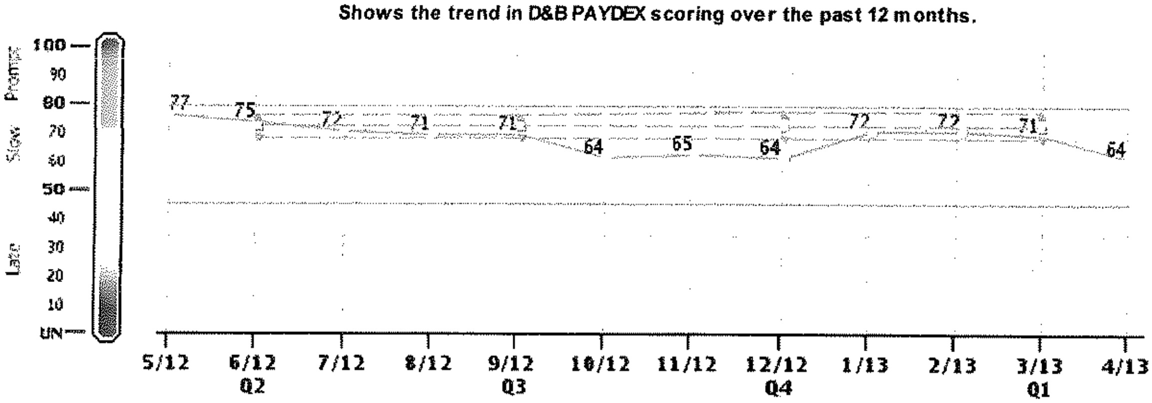
When weighted by amount, payments to suppliers average 25 days beyond terms

D&B PAYDEX® Comparison

Current Year

PAYDEX® of this Business compared to the Primary Industry from each of the last four quarters. The Primary Industry is Mfg industrial organic chemicals , based on SIC code 2869 .

Shows the trend in D&B PAYDEX scoring over the past 12 months.



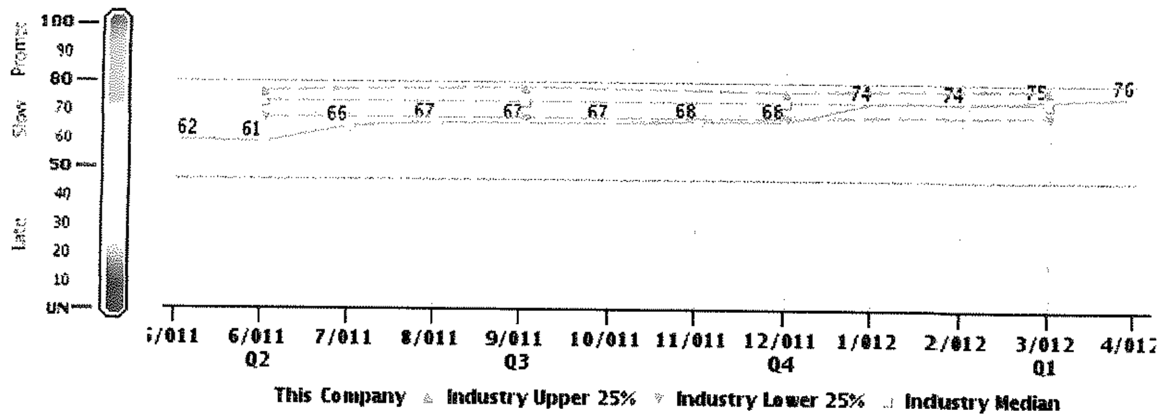
This Company **Industry Upper 25%** **Industry Lower 25%** **Industry Median**

	5/12	6/12	7/12	8/12	9/12	10/12	11/12	12/12	1/13	2/13	3/13	4/13
This Business	77	75	72	71	71	64	65	64	72	72	71	64
Industry Quartiles												
Upper	.	77	.	.	77	.	.	78	.	.	78	.
Median	.	74	.	.	74	.	.	74	.	.	74	.
Lower	.	70	.	.	70	.	.	70	.	.	70	.

Current PAYDEX for this Business is 64 , or equal to 19 days beyond terms
The 12-month high is 77 , or equal to 5 DAYS BEYOND terms
The 12-month low is 64 , or equal to 19 DAYS BEYOND terms

Previous Year

Shows PAYDEX of this Business compared to the Primary Industry from each of the last four quarters. The Primary Industry is Mfg industrial organic chemicals , based on SIC code 2869 .



Previous Year	06/11 Q2'11	09/11 Q3'11	12/11 Q4'11	03/12 Q1'12
This Business	61	67	68	75
Industry Quartiles				
Upper	77	78	77	78
Median	74	74	74	74
Lower	69	69	69	70

Based on payments collected over the last 4 quarters.

Current PAYDEX for this Business is 64 , or equal to 19 days beyond terms
The present industry median Score is 74 , or equal to 9 days beyond terms
Industry upper quartile represents the performance of the payers in the 75th percentile
Industry lower quartile represents the performance of the payers in the 25th percentile

Payment Habits

For all payment experiences within a given amount of credit extended, shows the percent that this Business paid within terms. Provides number of experiences to calculate the percentage, and the total credit value of the credit extended.

$ Credit Extended	# Payment Experiences	Total Amount	% of Payments Within Terms
Over 100,000	3	600,000	42%
50,000-100,000	0	0	0%
15,000-49,999	4	90,000	75%
5,000-14,999	3	22,500	0%
1,000-4,999	13	25,000	70%
Under 1,000	14	5,450	76%

0% 50% 100%

Based on payments collected over last 24 months.
All Payment experiences reflect how bills are paid in relation to the terms granted. In some instances, payment beyond terms can be the result of disputes over merchandise, skipped invoices etc.

Payment Summary

- There are 51 payment experience(s) in D&Bs file for the most recent 24 months, with 25 experience(s) reported during the last three month period.
- The highest Now Owes on file is 300,000 . The highest Past Due on file is 300,000

Below is an overview of the companys currency-weighted payments, segmented by its suppliers primary industries:

	Total Revd (#)	Total Amts	Largest High Credit	Within Terms (%)	Days Slow <31	31-60	61-90	90> (%) (%)
Top Industries								
Nonclassified	5	4,800	2,500	31	61	0	0	8
Short-trm busn credit	3	5,000	2,500	50	50	0	0	0
Whol misc profsn eqpt	2	41,000	40,000	100	0	0	0	0
Testing laboratory	2	5,750	5,000	13	87	0	0	0
Whol electrical equip	2	2,500	2,500	100	0	0	0	0
Mfg chemicals	1	300,000	300,000	0	100	0	0	0
Mfg organic chemicals	1	200,000	200,000	100	0	0	0	0
Railroad	1	100,000	100,000	50	0	50	0	0
Mfg sw itchgear-boards	1	20,000	20,000	100	0	0	0	0
Mfg process controls	1	15,000	15,000	0	100	0	0	0
Mfg signs/ad specltys	1	15,000	15,000	50	0	50	0	0
Misc equipment rental	1	10,000	10,000	0	100	0	0	0
Refuse system	1	7,500	7,500	0	50	0	0	50
Management services	1	2,500	2,500	0	100	0	0	0
Ret mail-order house	1	2,500	2,500	100	0	0	0	0
Misc business credit	1	2,500	2,500	100	0	0	0	0
Whol medical equip	1	2,500	2,500	100	0	0	0	0
Whol construct materl	1	1,000	1,000	100	0	0	0	0
Whol furniture	1	1,000	1,000	100	0	0	0	0
Local truck w /storage	1	1,000	1,000	100	0	0	0	0
Mfg lab apparatus	1	500	500	100	0	0	0	0
Misc publishing	1	500	500	100	0	0	0	0
Whol durable goods	1	500	500	100	0	0	0	0
Whol industrial suppl	1	500	500	100	0	0	0	0
Whol industrial equip	1	500	500	100	0	0	0	0
Mfg electric test prd	1	250	250	50	0	50	0	0
Coating/engrave svcs	1	250	250	0	100	0	0	0
Whol office equipment	1	250	250	50	0	0	0	50
Trucking non-local	1	100	100	100	0	0	0	0
Gravure printing	1	50	50	0	0	0	0	100
Photocopying service	1	0	0	0	0	0	0	0
Other payment categories								
Cash experiences	8	5,300	2,500					
Payment record unknow n	3	5,100	5,000					
Unfavorable comments	0	0	0					
Placed for collections	0	N/A	0					
Total in D&B's file	51	753,350	300,000					

Accounts are sometimes placed for collection even though the existence or amount of the debt is disputed.

Indications of slowness can be result of dispute over merchandise, skipped invoices etc.

Detailed payment history for this company

Date Reported (mm/yy)	Paying Record	High Credit	Now Owes	Past Due	Selling Terms	Last Sale Within (month)
03/13	Ppt	2,500	0	0	N30	1 mo
	Ppt	500	500	0		1 mo
	Ppt	100	0	0		6-12 mos
	Ppt	0	0	0	N30	2-3 mos
	Ppt-Slow 60	100,000	0	0		6-12 mos
	Ppt-Slow 150+	250	100	0		1 mo
	Slow 10	2,500	750	500		1 mo
	Slow 30	300,000	300,000	300,000		1 mo
	Slow 30	15,000	0	0		6-12 mos
	Slow 30	10,000	0	0		2-3 mos
	Slow 30	5,000	0	0		6-12 mos
	Slow 30	2,500	0	0		6-12 mos
	Slow 30	50	0	0		6-12 mos
	Slow 15-150	750	750	750		4-5 mos
	(015)	0	0	0	Cash account	4-5 mos
	(016)	0	0	0	Cash account	1 mo
	(017)	0	0	0	Cash account	1 mo
	(018)	0	0	0	Cash account	6-12 mos
02/13	Ppt	40,000	40,000	0		1 mo
	Ppt	20,000	0	0		4-5 mos
	Ppt	2,500	0	0		6-12 mos
	Ppt	2,500	0	0	N30	4-5 mos
	Ppt	500	0	0		6-12 mos
01/13	Ppt	1,000	0	0		6-12 mos
	Ppt	500	0	0	N60	6-12 mos
	(026)	2,500			Cash account	1 mo
	(027)	2,500			Cash account	1 mo
12/12	Ppt	200,000	100,000	0		1 mo
	Ppt	750	0	0	N30	6-12 mos
	Ppt	0	0	0		6-12 mos
	(031)	50				1 mo
	(032)	50				1 mo
11/12	Ppt-Slow 60	250	0	0	N30	6-12 mos
10/12	Ppt	0	0	0		6-12 mos
09/12	Ppt	2,500	0	0		6-12 mos
07/12	Slow 30	2,500	0	0	N30	6-12 mos
05/12	Ppt	500	0	0		6-12 mos
04/12	Ppt	1,000	0	0	N30	6-12 mos
	Slow 30	250	0	0		6-12 mos
03/12	Ppt	1,000	0	0		6-12 mos

	Ppt	1,000	0	0		6-12 mos
	Ppt	500	0	0		6-12 mos
	Ppt-Slow 60	15,000	0	0		6-12 mos
	(044)	250			Cash account	1 mo
02/12	(045)	50			Cash account	1 mo
11/11	Ppt	1,000	0	0	N30	6-12 mos
	Slow 30-90+	7,500	0	0		6-12 mos
	Slow 90+	50	0	0		6-12 mos
10/11	Ppt	2,500	50	0	Lease Agreemnt	
	(050)	5,000	0	0		6-12 mos
09/11	Ppt	500	0	0		6-12 mos

Payments Detail Key: 30 or more days beyond terms

Payment experiences reflect how bills are paid in relation to the terms granted. In some instances payment beyond terms can be the result of disputes over merchandise, skipped invoices, etc. Each experience shown is from a separate supplier. Updated trade experiences replace those previously reported.

Public Filings

Currency: Shown in USD unless otherwise indicated

Summary

The following data includes both open and closed filings found in D&B's database on this company.

Record Type	# of Records	Most Recent Filing Date
Bankruptcy Proceedings	0	-
Judgments	0	-
Liens	1	08/03/01
Suits	0	-
UCCs	2	08/27/07

The following Public Filing data is for information purposes only and is not the official record. Certified copies can only be obtained from the official source.

Liens

A lien holder can file the same lien in more than one filing location. The appearance of multiple liens filed by the same lien holder against a debtor may be indicative of such an occurrence.

Amount	**185,691**
Status	**Open**
CASE NO.	0108030665
Type	State Tax
Filed By	CA FRANCHISE TAX BOARD
Against	ISP CHEMICALS INC.
Where Filed	SACRAMENTO COUNTY RECORDERS OFFICE, SACRAMENTO, CA
Date Status Attained	08/03/01
Date Filed	08/03/01

Latest Info Received	09/01/09

UCC Filings

Collateral	Leased Equipment
Type	Original
Sec. Party	WILLIAMS SCOTSMAN, INC., BALTIMORE, MD
Debtor	ISP CHEMICALS INC
Filing No.	2005212009950
Filed With	SECRETARY OF STATE/UCC DIVISION, FRANKFORT, KY
Date Filed	2005-09-29
Latest Info Received	11/12/05

Type	Original
Sec. Party	AEL FINANCIAL, LLC, BUFFALO GROVE, IL
Debtor	ISP CHEMICAL PRODUCTS, INC.
Filing No.	2007 3571527
Filed With	SECRETARY OF STATE/UCC DIVISION, DOVER, DE
Date Filed	2007-08-27
Latest Info Received	10/17/07

Government Activity

Activity summary

Borrower (Dir/Guar)	NO
Administrative Debt	YES
Contractor	NO
Grantee	NO
Party excluded from federal program(s)	NO

Possible candidate for socio-economic program consideration

Labour Surplus Area	YES (2013)
Small Business	N/A
8(A) firm	N/A

The details provided in the Government Activity section are as reported to Dun & Bradstreet by the federal government and other sources.

Special Events

Currency: Shown in USD unless otherwise indicated

Special Events

11/01/2012

The Chief Executive Officer is now Sunil Kumar, Mng Mbr.

History & Operations

Currency: Shown in USD unless otherwise indicated

Company Overview

Company Name:	ISP CHEMICALS LLC
Doing Business As :	(SUBSIDIARY OF ISP CHEMICALS INC., WAYNE, NJ)
Street Address:	455 N Main St Calvert City, KY 42029
Mailing Address:	PO Box 37 Calvert City KY 42029
Phone:	270 395-4165
Fax:	270-395-1464
URL:	http://www.ispchemicals.com
History	Is clear
Present management control	6 years

History

The following information was reported: **11/01/2012**

Officer(s):	SUNIL KUMAR, MNG MBR NEIL MURPHY, MBR RICHARD WEINBERG, MBR STEVE POST, MBR SUSAN YOSS, MBR JASON POLLACK, MNG MBR KAM GREG, MNG MBR EDWARD T PROSAPIO, MNG MBR
DIRECTOR(S) :	THE OFFICER(S)

The Kentucky Secretary of State's business registrations file showed that ISP Chemicals LLC was registered as a Limited Liability Company on November 15, 2007.

Ownership information provided verbally by Gordon Miller, Credit Mgr, on Jan 06 2011.

Business started 2007 by Philip Berke.

SUNIL KUMAR. Antecedents are unknown.

NEIL MURPHY born 1946. Antecedents are unknown.

RICHARD WEINBERG. Antecedents are unknown.

STEVE POST. Antecedents are unknown.

SUSAN YOSS. Antecedents are unknown.

JASON POLLACK. Antecedents are unknown.

KAM GREG. Antecedents are unknown.

EDWARD T PROSAPIO. Antecedents are unknown.

Operations

11/01/2012

Description:	Subsidiary of ISP CHEMICALS INC., WAYNE, NJ started 1996 which operates as a manufacture of specialty derivative chemicals, mines and processes roofing granules and manufactures filters. Parent company owns 100% of capital stock. As noted, this company is a subsidiary of Isp Chemicals Inc., Duns number 13-541-2869, and reference is made to that report for background information on the parent and its management. Manufactures industrial organic chemicals (100%). Has 6000 account(s). Terms are Net 30 days. Sells to cosmetic and pharmaceutical companies. Territory : International. Nonseasonal.
Employees:	600 which includes partners. UNDETERMINED employed here.
Facilities:	Owns 10,000 sq. ft. in a one story concrete block building.
Location:	Central business section on main street.
Branches:	This business has multiple branches, detailed branch/division information is available in Dun & Bradstreet's linkage or family tree products.

SIC & NAICS

SIC:
Based on information in our file, D&B has assigned this company an extended 8-digit SIC. D&B's use of 8-digit SICs enables us to be more specific about a company's operations than if we use the standard 4-digit code.
The 4-digit SIC numbers link to the description on the Occupational Safety & Health Administration (OSHA) Web site. Links open in a new browser window.
2869 0000 Industrial organic chemicals, nec
NAICS:

325199 All Other Basic Organic Chemical Manufacturing

Financials

Currency: Shown in USD unless otherwise indicated

Company Financials: D&B

Additional Financial Data

As of November 1, 2012, attempts to contact the management of this business have been unsuccessful. Inside source confirmed the name of the business. Outside sources confirmed operation and location.

Key Business Ratios

D & B has been unable to obtain sufficient financial information from this company to calculate business ratios. Our check of additional outside sources also found no information available on its financial performance.

To help you in this instance, ratios for other firms in the same industry are provided below to support your analysis of this business.

Based on this Number of Establishments 20

Industry Norms Based On 20 Establishments

	This Business	Industry Median	Industry Quartile
Profitability			
	UN	0.1	UN
	UN	0.5	UN
Short-Term Solvency			
	UN	1.8	UN
	UN	0.9	UN
Efficiency			
	UN	53.4	UN
	UN	17.9	UN
Utilization			
	UN	93.2	UN

UN = Unavailable

Delaware

The First State

I, JEFFREY W. BULLOCK, SECRETARY OF STATE OF THE STATE OF DELAWARE, DO HEREBY CERTIFY THE ATTACHED IS A TRUE AND CORRECT COPY OF THE CERTIFICATE OF MERGER, WHICH MERGES:

"BASF CONSTRUCTION CHEMICALS, LLC", A DELAWARE LIMITED LIABILITY COMPANY,

"BASF PERFORMANCE PRODUCTS LLC", A DELAWARE LIMITED LIABILITY COMPANY,

"BASF POLYURETHANE FOAM ENTERPRISES LLC", A DELAWARE LIMITED LIABILITY COMPANY,

WITH AND INTO "BASF CORPORATION" UNDER THE NAME OF "BASF CORPORATION", A CORPORATION ORGANIZED AND EXISTING UNDER THE LAWS OF THE STATE OF DELAWARE, AS RECEIVED AND FILED IN THIS OFFICE THE FIFTEENTH DAY OF DECEMBER, A.D. 2010, AT 3:11 O'CLOCK P.M.

AND I DO HEREBY FURTHER CERTIFY THAT THE EFFECTIVE DATE OF THE AFORESAID CERTIFICATE OF MERGER IS THE FIRST DAY OF JANUARY, A.D. 2011, AT 12:01 O'CLOCK A.M.

A FILED COPY OF THIS CERTIFICATE HAS BEEN FORWARDED TO THE NEW CASTLE COUNTY RECORDER OF DEEDS.

Jeffrey W. Bullock, Secretary of State

0842062 8100M

AUTHENTICATION: 8465444

101192722

DATE: 12-31-10

State of Delaware
Secretary of State
Division of Corporations
Delivered 04:49 PM 12/15/2010
FILED 03:11 PM 12/15/2010
SRV 101192722 - 0842062 FILE

STATE OF DELAWARE
CERTIFICATE OF MERGER
OF
BASF CONSTRUCTION CHEMICALS, LLC,
BASF POLYURETHANE FOAM ENTERPRISES LLC, AND
BASF PERFORMANCE PRODUCTS LLC
INTO
BASF CORPORATION

Pursuant to Title 8, Section 264(c) of the Delaware General Corporation Law and Title 6, Section 18-209 of the Delaware Limited Liability Company Act, the undersigned corporation executed the following Certificate of Merger:

FIRST: The name of the surviving corporation is **BASF Corporation,** a Delaware corporation, and the names of the limited liability companies being merged into this surviving corporation are **BASF Construction Chemicals, LLC, BASF Polyurethane Foam Enterprises LLC,** and **BASF Performance Products LLC**, each of which is a Delaware limited liability company.

SECOND: The Plan and Agreement of Merger has been approved, adopted, certified, executed and acknowledged by the surviving corporation and each of the merging limited liability companies.

THIRD: The name of the surviving corporation is **BASF Corporation.**

FOURTH: The merger is to become effective as of January 1, 2011 at 12:01 a.m.

FIFTH: The Plan and Agreement of Merger is on file at 100 Campus Drive, Florham Park, New Jersey 07932, the place of business of the surviving corporation.

SIXTH: A copy of the Plan and Agreement of Merger will be furnished by the corporation on request, without cost, to any stockholder of any constituent corporation or member of any constituent limited liability company.

SEVENTH: The Certificate of Incorporation of the surviving corporation shall be its Certificate of Incorporation.

IN WITNESS WHEREOF, said Corporation has caused this certificate to be signed by an authorized officer, the 15th day of December 2010.

BASF CORPORATION

By:________________________________

Authorized Officer

Name: David M. Stryker

Title: Senior Vice President, General Counsel & Secretary

Delaware

The First State

I, JEFFREY W. BULLOCK, SECRETARY OF STATE OF THE STATE OF DELAWARE DO HEREBY CERTIFY THAT THE ATTACHED IS A TRUE AND CORRECT COPY OF THE CERTIFICATE OF CONVERSION OF A DELAWARE CORPORATION UNDER THE NAME OF "CIBA CORPORATION" TO A DELAWARE LIMITED LIABILITY COMPANY, CHANGING ITS NAME FROM "CIBA CORPORATION" TO "BASF PERFORMANCE PRODUCTS LLC", FILED IN THIS OFFICE ON THE TWENTY-NINTH DAY OF MARCH, A.D. 2010, AT 12:48 O'CLOCK P.M.

AND I DO HEREBY FURTHER CERTIFY THAT THE EFFECTIVE DATE OF THE AFORESAID CERTIFICATE OF CONVERSION IS THE FIRST DAY OF APRIL, A.D. 2010, AT 12:02 O'CLOCK A.M.

SECRETARY'S OFFICE 1793 DELAWARE 1855

Jeffrey W. Bullock, Secretary of State

2654123 8100V

AUTHENTICATION: 7900714

100326363

DATE: 03-30-10

You may verify this certificate online at corp.delaware.gov/authver.shtml

State of Delaware
Secretary of State
Division of Corporations
Delivered 12:47 PM 03/29/2010
FILED 12:48 PM 03/29/2010
SRV 100326363 - 2654123 FILE

CERTIFICATE OF CONVERSION TO LIMITED LIABILITY COMPANY OF CIBA CORPORATION TO BASF PERFORMANCE PRODUCTS LLC

This Certificate of Conversion to Limited Liability Company, dated as of March 29, 2010, is being duly executed and filed by an authorized person, to convert Ciba Corporation (the "Corporation") to a Delaware limited liability company, under the Delaware Limited Liability Company Act (Del. Code Ann. Tit. 6, §§ 18-101 *et. seq.*) (the "Act") and the General Corporation Law of the State of Delaware (Del. Code Ann. Tit. 8, §§101, *et. seq.*) (the "**DGCL**").

1. The Corporation filed its original certificate of incorporation with the Secretary of State of the State of Delaware on August 16, 1996.

2. The name of the Corporation immediately prior to the filing of this Certificate of Conversion to Limited Liability Company was Ciba Corporation.

3. The name of the limited liability company formed into which the Corporation shall be converted as set forth in its Certificate of Formation is BASF Performance Products LLC.

4. The conversion of the Corporation to a limited liability company shall be effective on April 1, 2010 at 12:02 a.m.

5. The conversion of the Corporation to a limited liability company has been approved in accordance with the provisions of Section 266 of the DGCL and Section 18-214 of the Act.

6. For U.S. federal income tax purposes, it is intended that the conversion of the Corporation to a limited liability company qualify as a complete liquidation of the Corporation within the meaning of Section 332 of the Internal Revenue Code of 1986, as amended.

7. When the Corporation has been converted to a Delaware limited liability company pursuant to Section 18-214 of the Delaware Limited Liability Company Act and to Section 266 of the General Corporation Law of the State of Delaware, the limited liability company will, for all purposes of the laws of the State of Delaware, be the same entity as the converting Corporation. For all purposes of the laws of the State of Delaware, the rights, privileges, powers and interest in property of the converting Corporation, as well as the debts, liabilities and duties of the Corporation, will not, as a consequence of the conversion, be transferred to the Delaware limited liability company; the converting Corporation will not wind up its affairs or pay its liabilities

and distribute its assets; the conversion will not constitute a dissolution of the Corporation; and the conversion will constitute a continuation of the existence of the converting Corporation in the form of a Delaware limited liability company.

IN WITNESS WHEREOF, the undersigned have executed and filed this Certificate of Conversion as of the date first above written.

CIBA CORPORATION

By: ______________________

Authorized Person
Keith H. Ansbacher
Assistant Secretary

CERTIFICATE OF ASSISTANT SECRETARY
BASF CORPORATION

The undersigned, Keith H. Ansbacher, a duly elected and qualified Assistant Secretary of **BASF CORPORATION** (the "Corporation"), a Delaware corporation, hereby certifies as follows:

1. that I am a duly elected and qualified assistant secretary of the Corporation; and

2. that the Corporation is the sole member of BASF Catalysts Holding, LLC, a Delaware limited liability company ("Holding"); and

3. that Holding is the sole member of BASF Catalysts LLC, a Delaware limited liability company.

IN WITNESS WHEREOF, I have subscribed my name as of this 25th day of February 2013

Keith H. Ansbacher
Assistant Secretary

[SEAL]

ASSISTANT SECRETARY'S CERTIFICATE

I, Keith R. Abrams, Assistant Secretary of Bayer Corporation, an Indiana corporation having its principal place of business at 100 Bayer Road, Pittsburgh, PA 15205, hereby certify as follows:

1. That I have access to the minutes books and records of Bayer Corporation, including records indicating the ownership interest of Bayer Corporation in various direct and indirect subsidiaries;

2. That on November 2, 1994, Miles Inc. acquired all of the stock of Sterling Winthrop, Inc.;

3. That on April 1, 1995, Miles Inc. changed its name to Bayer Corporation;

4. That on September 30, 1996, Sterling Winthrop, Inc. changed its name to STWB Inc.; and

5. That as a result of the aforementioned transactions, STWB Inc. is a wholly-owned, direct subsidiary of Bayer Corporation.

IN WITNESS WHEREOF, I have hereunto subscribed my name and seal this 25th day of February, 2013.

Keith R. Abrams

Keith R. Abrams, Assistant Secretary

NEWELL RUBBERMAID INC.

Certificate of Ownership

I, Michael R. Peterson, do hereby certify that I am the duly qualified Assistant Secretary and the keeper of the records and corporate seal of Newell Rubbermaid Inc., a Delaware corporation ("Newell Rubbermaid"), and that the following is true and correct as of the date set forth below.

Goody Products, Inc., a Delaware corporation, is a directly wholly-owned subsidiary of Newell Rubbermaid. Berol Corporation, a Delaware corporation, is an indirectly wholly-owned subsidiary of Newell Rubbermaid.

IN WITNESS WHEREOF, I have affixed my name as Assistant Secretary this 23rd day of April, 2013.

Michael R. Peterson, Assistant Secretary

Glenn A. Harris, Esquire
BALLARD SPAHR LLP
A Pennsylvania Limited Liability Partnership
210 Lake Drive East, Suite 200
Cherry Hill, New Jersey 08002
Phone: 856.761.3400
Fax: 856.761.1020

Attorneys for Third-Party Defendant BP Products North America Inc.

NEW JERSEY DEPARTMENT OF ENVIRONMENTAL PROTECTION and THE ADMINISTRATOR OF THE NEW JERSEY SPILL COMPENSATION FUND, Plaintiffs, v. OCCIDENTAL CHEMICAL CORPORATION, TIERRA SOLUTIONS, INC., MAXUS ENERGY CORPORATION, REPSOL YPF, S.A., YPF, S.A., YPF HOLDINGS, INC. and CLH HOLDINGS, INC., Defendants. MAXUS ENERGY CORPORATION and TIERRA SOLUTIONS, INC., Third-Party Plaintiffs, vs. 3M COMPANY, *et al.*, Third-Party Defendants.	SUPERIOR COURT OF NEW JERSEY LAW DIVISION: ESSEX COUNTY DOCKET NO. L-9868-05 CIVIL ACTION **CERTIFICATION OF CYNTHIA D. KEZOS**

Cynthia D. Kezos, being of full age, makes the following certified statements:

1. I am the Strategy Manager for Remediation Management for BP America Inc. I have responsibility for this litigation for BP Products North America Inc. ("BP Products") and for Atlantic Richfield Company ("ARC").

2. I have personal knowledge of the facts set forth herein.

3. BP Products was incorrectly named in Third-Party Complaint D as "BP Marine Americas, Inc." The name "BP Marine Americas" was used historically by BP Products as an assumed name/trade name in the states of New Jersey, Florida, and Texas. There is no corporation named BP Marine Americas, Inc.

4. BP Products is the entity that has leased and operated the facility identified in Third-Party Complaint D as the "BP Marine Americas, Inc. Site."

5. BP Products is indirectly wholly-owned by BP America Inc.

6. ARC is not named in any Third-Party Complaint, but is alleged to be a prior owner of the facility identified in Third-Party Complaint D as the "Hess Corporation Site."

7. ARC is directly wholly-owned by BP America Inc.

8. Thus, ARC is an Unnamed Affiliated Entity, as it and BP Products are directly or indirectly wholly-owned by the same parent company.

I certify that the foregoing statements made by me are true. I am aware that if any of the foregoing statements made by me are wilfully false, I am subject to punishment.

By: Cynthia D Kezos
Cynthia D. Kezos

DATED: March 7, 2013

NEW JERSEY DEPARTMENT OF ENVIRONMENTAL PROTECTION, THE COMMISSIONER OF THE NEW JERSEY DEPARTMENT OF ENVIRONMENTAL PROTECTION and THE ADMINISTRATOR OF THE NJ SPILL COMPENSATION FUND, Plaintiffs, vs. OCCIDENTAL CHEMICAL CORPORATION, TIERRA SOLUTIONS, INC., MAXUS ENERGY CORPORATION, REPSOL YPF, S.A., YPF HOLDINGS, INC. and CLH HOLDINGS, INC., Defendants. MAXUS ENERGY CORPORATION and TIERRA SOLUTIONS, INC., Third-Party Plaintiffs, v. 3M COMPANY, *et al.* Third-Party Defendants.	SUPERIOR COURT OF NEW JERSEY LAW DIVISION: ESSEX COUNTY DOCKET NO. L-9868-05 (PASR) Civil Action **CERTIFICATION OF WILLIAM M. HASKEL**

WILLIAM M. HASKEL, of full age certifies as follows:

1. I am the General Counsel of Cambrex Corporation (the "Company") and in that capacity have personal knowledge of the Company's affiliates. Cosan Corporation and CasChem, Inc. are wholly owned subsidiaries of the Company.

2. Cosan Corporation and CasChem, Inc., third party defendants in this lawsuit, have executed the draft Consent Judgment in order to participate in the settlement with the Plaintiffs in this litigation.

The foregoing statements made by me are true. I am aware that if the foregoing statements made by me are willfully false, I am subject to punishment.

WILLIAM M. HASKEL
Sr. Vice President and General Counsel
Cambrex Corporation
One Meadowlands Plaza
East Rutherford, New Jersey 07073

Dated: April 19, 2013

CERTIFICATION OF LOUISA LITTLE ON BEHALF OF SETTLING THIRD-PARTY DEFENDANTS GOLDMAN/GOLDMAN/DILORENZO PROPERTIES PARTNERSHIPS AND DILORENZO PROPERTIES COMPANY, L.P.

I, Louisa Little, do hereby certify that:

1. I am the authorized representative of the Goldman/Goldman/DiLorenzo Properties Partnerships ("GGD"), and I am authorized to make this certification.

2. GGD was a general partnership comprised of Sol Goldman, Irving Goldman, and DiLorenzo Properties Company, L.P. ("DiLorenzo").

3. GGD (through a nominee) acquired the American Modern Metals Site (the "Property") in Kearny in 1959.

4. The partners agreed to terminate GGD in 1988.

5. As part of the termination, the partners of GGD distributed the primary assets of the partnership among the partners, with one of the general partners (DiLorenzo) receiving a distribution of the Property. The termination agreement provided that the GGD partners would retain responsibility for the environmental issues associated with the Property. GGD's cleanup obligation was set forth in a 1988 ISRA Administrative Consent Order.

6. DiLorenzo, as successor owner of the Property, continued to hold title to the Property until 1992, when the Property was sold to Kearny Industrial Associates, a property holding company affiliated with American Modern Metals Co.

7. Neither GGD nor DiLorenzo were operators or successors to the operators at the Property.

8. Since the partnership termination in 1988, the three partners have been paying all environmental costs related to the Property on a pro rata basis.

9. Both Goldman/Goldman/DiLorenzo Properties Partnerships and DiLorenzo Properties Company, L.P. are "Settling Third-Party Defendants" as defined in paragraph 18.32 of the Consent Judgment.

Louisa Little

Louisa Little

DATE:

The Dow Chemical Company
Midland, Michigan 48674
USA

The Dow Chemical Company
Assistant Secretary's Certificate

I, Amy E. Wilson, Assistant Secretary of The Dow Chemical Company, a Delaware corporation with offices at 2030 Dow Center, Midland, Michigan, United States of America (the "Company"), do hereby certify that:

1. Attached hereto as Exhibit A is a true and correct copy of Exhibit 21 listing the subsidiaries of The Dow Chemical Company as found in the 10-K Annual Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2012, Commission file number 1-3433 of the Company filed with the Securities and Exchange Commission of the United States of America on February 15, 2013.

IN WITNESS WHEREOF, I have signed this Assistant Secretary's Certificate and affixed the corporate seal of the Company this 27th day of February, 2013.

Amy E. Wilson
Assistant Secretary

UNITED STATES OF AMERICA)
STATE OF MICHIGAN) ss.
COUNTY OF MIDLAND)

Subscribed and sworn to before me, a notary public, this 27th day of February, 2013.

LAUREN G VERMEERSCH
Notary Public - Michigan
Tuscola County
My Commission Expires Feb 16, 2018
Acting in the County of Midland

Lauren G. Vermeersch
Notary Public

Subsidiaries of The Dow Chemical Company **EXHIBIT 21**

At December 31, 2012

	*Location**	*% Ownership*
This list includes companies for which the effective ownership by The Dow Chemical Company is 50 percent or more.		
The Dow Chemical Company	Delaware	
Advanced Electrolyte Technologies LLC (1)	Delaware	50
Arabian Chemical Company (Latex) Ltd. (1)	Saudi Arabia	50
Arabian Chemical Company (Polystyrene) Limited (1)	Saudi Arabia	50
Battleground Water Company (70)	Texas	9
Biotechnology Research and Development Corporation	Delaware	100
Buildscape, Inc.	Florida	100
Buildscape, LLC	Delaware	100
CanStates Holdings Inc.	Oklahoma	100
ANGUS Chemical Company	Delaware	100
CD Polymers Inc.	Delaware	100
Centen Ag Inc.	Delaware	100
Dow AgroSciences LLC (10)	Delaware	39
DowBrands Inc. (15)	Delaware	8
Liana Limited (19)	Delaware	2
Mycogen Corporation (14)	California	12
Chemars III LLC	Delaware	100
Chemtech II L.P. (9)	Delaware	22
Clean Filtration Technologies LLC	Delaware	100
DC Partnership Management Inc.	Delaware	100
DowBrands L.P. (7)	Delaware	42
DCOMCO, Inc.	Delaware	100
Denmerco Inc.	Delaware	100
Diamond Capital Management Inc.	Delaware	100
Dofinco, Inc.	Delaware	100
Dow Business Services LLC	Delaware	100
Dow Capital International LLC	Delaware	100
Dow Chemical (Australia) Limited	Australia	100
Dow Australia Superannuation Fund A Pty Limited	Australia	100
Dow Chemical (China) Investment Company Limited	China	100
Dow Chemical (Guangzhou) Company Limited	China	100
Dow Chemical (Shanghai) Company Limited	China	100
Dow Chemical (Zhangjiagang) Company Limited	China	100
Guangdong Zhongshan Amerchol Specialty Chemicals Co., Ltd.	China	90
Zhejiang Pacific Chemical Corporation	China	100
Dow Chemical China Holdings Pte. Ltd.	Singapore	100
Dow Chemical Delaware Corp.	Delaware	100
Chemtech II L.P. (9)	Delaware	73
Chemtech Portfolio Inc. (12)	Texas	33
Chemtech Portfolio II Inc.	Michigan	100
Dow Chemical International Ltd.	Delaware	100

Subsidiaries of The Dow Chemical Company **EXHIBIT 21**

At December 31, 2012

	*Location**	*% Ownership*
This list includes companies for which the effective ownership by The Dow Chemical Company is 50 percent or more.		
Dow Chemical Thailand Ltd.	Thailand	100
Dow International Holdings Company (23)	Delaware	1
Dow International Holdings S.A. (74)	Switzerland	1
Pacific Plastics (Thailand) Limited (41)	Thailand	51
Petroquimica-Dow S.A. (Petrodow)	Chile	100
Dow Chemical Korea Limited (34)	Korea	86
Dow Chemical Kuwait B.V.	Netherlands	100
Dow Chemical (NZ) Limited	New Zealand	100
Dow Chemical Pacific Limited	Hong Kong	100
Dow Chemical Pacific (Singapore) Private Limited	Singapore	100
A-Tec Chemical Pte. Ltd.	Singapore	100
A-Tec Chemical Science (Beijing) Company Limited	China	100
Dow Chemical (Malaysia) Sdn. Bhd.	Malaysia	100
Dow Chemical International Pvt. Ltd. (27)	India	99
PT Dow Indonesia (62)	Indonesia	99
Dow Chemical (Singapore) Private Limited	Singapore	100
Dow Chemical International Pvt. Ltd. (27)	India	1
PT Dow Indonesia (62)	Indonesia	1
Dow Chemical Taiwan Limited	Taiwan	100
Dow Chemical Telecommunications Corp.	Delaware	100
Dow Credit Corporation	Delaware	100
Dow Customs & Trade LLC	Delaware	100
Dow Deutschland Inc.	Delaware	100
Dow Chemical Inter-American Limited	Delaware	100
Dow Quimica de Colombia S.A. (6)	Colombia	10
Dow Deutschland Management Inc.	Delaware	100
Dow Engineering Company	Delaware	100
Dow Engineering, Inc.	Michigan	100
Dow Environmental Inc.	Delaware	100
Dow Financial Services Inc.	Delaware	100
Dow Global Technologies LLC	Delaware	100
Chemtech Portfolio Inc. (12)	Texas	67
Stonehenge Community Development XVII, LLC	Delaware	99
Dow Technology Investments LLC (37)	Delaware	50
Dow Holdings LLC	Delaware	100
Dow Corning Corporation (3)	Michigan	50
Dow Hydrocarbons and Resources LLC	Delaware	100
Cayuse Pipeline, Inc.	Texas	100
Dow Intrastate Gas Company	Louisiana	100
Dow Pipeline Company	Texas	100
K/D/S Promix, LLC (1)	Texas	50

Subsidiaries of The Dow Chemical Company **EXHIBIT 21**

At December 31, 2012

	*Location**	*% Ownership*
This list includes companies for which the effective ownership by The Dow Chemical Company is 50 percent or more.		
Midland Pipeline Corp.	Delaware	100
Fort Saskatchewan Ethylene Storage Corporation (1)	Canada	50
Fort Saskatchewan Ethylene Storage Limited Partnership (2) (13)	Canada	1
DowBrands L.P. (7)	Delaware	58
Dow Internacional Mexicana S.A. de C.V.	Mexico	100
Dow International B.V.	Netherlands	100
Dow International Financial Services	Ireland	100
Dow Capital Public Limited Company	Ireland	100
Dow International Holdings Company (23)	Delaware	72
DC Spectrum Holding C.V. (38)	Netherlands	97
Coöperatieve DC Prisma Holding U.A. (39)	Netherlands	99
Dow Dutch Holding B.V.	Netherlands	100
DC Galaxy Holding C.V. (40)	Netherlands	1
Dow International Holdings S.A. (74)	Switzerland	99
3243424 Nova Scotia Company	Canada	100
DC Galaxy Holding C.V. (40)	Netherlands	99
Dow Europe Holding B.V.	Netherlands	100
Acima AG fur Chemische Industrie	Switzerland	100
BASF DOW HPPO B.V. (1)	Netherlands	50
BASF DOW HPPO Technology B.V. (1)	Netherlands	50
Dow Austria Gesellschaft m.b.H.	Austria	100
Dow Bahrain Holding W.L.L. (46)	Bahrain	90
Dow Belgium B.V.B.A.	Belgium	100
Dow Benelux B.V.	Netherlands	100
Dow Netwerk B.V.	Netherlands	100
Emergo Finance C.V. (1)	Netherlands	50
Polyol Belgium B.V.B.A. (11)	Belgium	99
Valuepark Terneuzen Beheer B.V. (1)	Netherlands	50
Valuepark Terneuzen C.V. (1) (26)	Netherlands	1
Dow Beteiligungsgesellschaft mbH & Co. KG	Germany	100
Dow Olefinverbund GmbH (43)	Germany	5
Dow Chemical Company Limited	United Kingdom	100
Ascot Group Pension Trustees Limited	United Kingdom	100
Cromarty Petroleum Company Limited (1)	United Kingdom	50
Dow Chemical Services UK Limited	United Kingdom	100
Dow Services Trustees UK Limited	United Kingdom	100
Haltermann Pension Trustees Limited	United Kingdom	100
Hyperlast Limited	United Kingdom	100
ALH Rail Coatings Limited (1)	United Kingdom	50
Hypertec Print Services Limited	United Kingdom	100
Xitrack Limited (1)	United Kingdom	50

Subsidiaries of The Dow Chemical Company **EXHIBIT 21**

At December 31, 2012

	*Location**	*% Ownership*
This list includes companies for which the effective ownership by The Dow Chemical Company is 50 percent or more.		
Suter Limited	United Kingdom	100
Dow Chemical East Africa Limited (76)	Kenya	90
Dow Chemical Iberica S.L.	Spain	99
Terminal de Atraque de Productos Petroquimicos, A.I.E. (1)	Spain	50
Transformadora de Etileno A.I.E. (1)	Spain	50
Dow Chemical Korea Limited (34)	Korea	14
Dow Chemical OOO	Russia	100
Dow Chemical Romania S.R.L.	Romania	100
Dow Chemical West Africa Limited	Ghana	100
Dow Deutschland Verwaltungs Vertriebs GmbH	Germany	100
Dow Deutschland Vertriebs GmbH & Co. OHG (73)	Germany	30
Dow Europe GmbH	Switzerland	100
Dolpa S.a.r.l.	Luxembourg	100
Dow Chemical IMEA GmbH	Switzerland	100
Dow Contract Services FZE	Dubai	100
Dow Egypt Services Limited (42)	Egypt	25
Dow International Finance S.a.r.l.	Luxembourg	100
Dow Mideast Systems S.A.E. (JSC) (4)	Egypt	1
Dow France S.A.S.	France	100
Dow Hellas A.E.	Greece	100
Dow Hungary Kft.	Hungary	100
Dow InterBranch B.V.	Netherlands	100
Business Process Service Center Terneuzen B.V.	Netherlands	100
Dow Bahrain Holding W.L.L. (46)	Bahrain	10
Dow Chemical East Africa Limited (76)	Kenya	10
Dow Danmark A/S	Denmark	100
Dow Mideast Systems S.A.E. (JSC) (4)	Egypt	1
Dow Norge A/S	Norway	100
Dow Saudi Arabia Company (35)	Saudi Arabia	15
Dow Turkiye Kimya Sanayi ve Ticaret Limited Sirketi (5)	Turkey	1
Dow Zwijndrecht B.V.B.A. (20)	Belgium	1
Santa Vitoria Acucar e Alcool Ltda. (2)	Brazil	50
Dow Italia s.r.l.	Italy	100
Dow AgroSciences Italia s.r.l.	Italy	100
Dow Italia Divisione Commerciale s.r.l.	Italy	100
Dow Mideast Systems S.A.E. (JSC) (4)	Egypt	98
Dow Egypt Services Limited (42)	Egypt	75
Dow Narmer Holding B.V.	Netherlands	100
Rohm and Haas (UK) Holdings Ltd.	United Kingdom	100
Morton International Limited	United Kingdom	100
Rohm and Haas Electronic Materials Europe Ltd.	United Kingdom	100

Subsidiaries of The Dow Chemical Company **EXHIBIT 21**

At December 31, 2012

This list includes companies for which the effective ownership by The Dow Chemical Company is 50 percent or more.

	*Location**	*% Ownership*
Rohm and Haas UK Investment Ltd.	United Kingdom	100
Rohm and Haas (UK) Limited	United Kingdom	100
Rohm and Haas (Scotland) Limited	United Kingdom	100
Rohm and Haas Electronic Materials AB	Sweden	100
Rohm and Haas Electronic Materials Holdings UK Ltd.	United Kingdom	100
Dow Olefinverbund GmbH (43)	Germany	95
ANGUS Chemie GmbH	Germany	100
Dow Stade Produktions GmbH & Co. OHG (30)	Germany	30
Dow Wolff Cellulosics GmbH & Co. OHG (36)	Germany	50
Dow AgroSciences GmbH	Germany	100
Dow Deutschland Anlagengesellschaft mbH	Germany	100
Dow Wolff Cellulosics GmbH	Germany	100
UPPC GmbH	Germany	100
Dow MF Verwaltungs GmbH	Germany	100
Dow MF Produktion GmbH & Co. OHG (71)	Germany	30
Dow Pipeline Gesellschaft mbH & Co. KG	Germany	80
Dow Pipeline Verwaltungsgesellschaft mbH	Germany	80
SAFECHEM Europe GmbH	Germany	100
Dow Deutschland Vertriebs GmbH & Co. OHG (73)	Germany	70
Dow MF Produktion GmbH & Co. OHG (71)	Germany	70
Dow Stade Produktions GmbH & Co. OHG (30)	Germany	70
Dow Wolff Cellulosics GmbH & Co. OHG (36)	Germany	50
Dow Polska Sp.z.o.o.	Poland	100
Dow Portugal - Produtos Quimicos, Unipessoal, Lda.	Portugal	100
Dow Saudi Arabia Company (35)	Saudi Arabia	85
Dow Saudi Arabia Holding B.V.	Netherlands	100
Dow Saudi Arabia Product Marketing B.V.	Netherlands	100
Dow Southern Africa (Pty) Ltd	South Africa	100
Dow Suomi OY	Finland	100
Dow Sverige AB	Sweden	100
Dow Turkiye Kimya Sanayi ve Ticaret Limited Sirketi (5)	Turkey	99
Dow (Wilton) Limited	United Kingdom	100
Dow Zwijndrecht B.V.B.A. (20)	Belgium	99
DowAksa Advanced Composites Holdings B.V. (1)	Netherlands	50
Edulan A/S	Denmark	100
HPPO Holding & Finance C.V. (1)	Netherlands	50
MEGlobal B.V. (1)	Netherlands	50
MTP HPJV C.V. (2)	Netherlands	50
MTP HPJV Management B.V. (2)	Netherlands	50
Polyol Belgium B.V.B.A. (11)	Belgium	1
Rohm and Haas Bermuda Partner I GP (60)	Bermuda	99

Subsidiaries of The Dow Chemical Company

At December 31, 2012

EXHIBIT 21

This list includes companies for which the effective ownership by The Dow Chemical Company is 50 percent or more.

	*Location**	*% Ownership*
Rohm and Haas Denmark Bermuda GP ApS	Denmark	100
Rohm and Haas Bermuda GP (61)	Bermuda	47
Rohm and Haas Denmark Holding Company ApS	Denmark	100
Finndisp Ltd.	Russia	100
Limited Liability Company "Rohm and Haas"	Russia	100
Rohm and Haas B.V.	Netherlands	100
Rohm and Haas Espana Production Holding, S.L.	Spain	100
Rohm and Haas Espana, S.L.	Spain	100
Rohm and Haas Europe Sales ApS	Denmark	100
Rohm and Haas International SNC (66)	France	1
Rohm and Haas Europe Services ApS	Denmark	100
Rohm and Haas Europe Trading ApS	Denmark	100
RH Switzerland Production Holding GmbH	Switzerland	100
Rohm and Haas Electronic Materials Schweiz GmbH	Switzerland	100
Rohm and Haas Nordiska AB	Sweden	100
Rohm and Haas South Africa (PTY) Limited	South Africa	100
Rohm and Haas France Finance SAS	France	100
Rohm and Haas Italia S.r.l.	Italy	100
Rohm and Haas Kimya Sanayi Limited Sirketi (63)	Turkey	99
Rohm and Haas Kimya Ticaret Limited Sirketi (64)	Turkey	99
Rohm and Haas Kimyasal Urunler Uretim Dagitim ve Ticaret A.S. (65)	Turkey	59
Rohm and Haas International SNC (66)	France	99
Rohm and Haas France Production Holding SAS	France	100
Rohm and Haas France S.A.S.	France	100
Morton International S.A.S.	France	100
Rohm and Haas Polska Sp. z o.o.	Poland	100
Rohm and Haas Bermuda Partner II GP (67)	Bermuda	99
Rohm and Haas Bermuda GP (61)	Bermuda	53
Rohm and Haas Finland Oy	Finland	100
Rohm and Haas Nederland B.V.	Netherlands	100
RUS Polyurethanes Holding B.V.	Netherlands	58
Dow Izolan OOO (44)	Russia	100
Dow Izolan Ukraine LLC (45)	Ukraine	100
UC Investment B.V.	Netherlands	100
EQUATE Marketing Company E.C. (1)	Bahrain	50
Rofan Automation and Information Systems B.V.	Netherlands	100
Terneuzen Partnership Services B.V.	Netherlands	100
Valuepark Terneuzen C.V. (1) (26)	Netherlands	49
Dow Netherlands Investments LLC	Delaware	100
Coöperatieve DC Prisma Holding U.A. (39)	Netherlands	1
Dow Netherlands Holdings LLC	Delaware	100

Subsidiaries of The Dow Chemical Company **EXHIBIT 21**

At December 31, 2012

	*Location**	*% Ownership*
This list includes companies for which the effective ownership by The Dow Chemical Company is 50 percent or more.		
DC Spectrum Holding C.V. (38)	Netherlands	1
DowBrands Inc. (15)	Delaware	79
Dow International Technology Corporation	Delaware	100
Dow Kakoh Kabushiki Kaisha	Japan	65
Dow Kokam LLC	Delaware	65
Dow Kokam MI, LLC	Delaware	100
Dow Kokam MO, LLC	Delaware	100
Dow Peru S.A. (25)	Peru	91
Dow Quimica Argentina S.A. (21)	Argentina	76
Dow Quimica Chilena S.A. (22)	Chile	89
Dow Quimica de Colombia S.A. (6)	Colombia	90
Dow Quimica Mexicana S.A. de C.V. (17)	Mexico	85
Dow Roofing Systems LLC	Delaware	100
Dow South Africa Holdings (Pty) Ltd.	South Africa	100
Sentrachem Limited	South Africa	100
Cisvaal (Proprietary) Limited	South Africa	100
Minchem International Inc.	Panama	100
Dow Trent Limited	United Kingdom	100
Dow UK Limited	United Kingdom	100
Dow Venezuela, C.A. (8)	Venezuela	46
Dow Verwaltungsgesellschaft mbH	Germany	100
Dow-Mitsui Chlor-Alkali LLC (2)	Delaware	50
DSL Holdings Inc.	Delaware	100
DW Dexco Investment LLC	Delaware	100
Essex Chemical Corporation	New Jersey	100
Essex Specialty Products LLC	New Jersey	100
American Mortell Corporation	Texas	100
Mortell Company	Delaware	100
Dow Chemical (Wuhan) Company Limited	China	100
Dow International Holdings Company (23)	Delaware	8
GWN Holding, Inc. (31)	Delaware	25
FilmTec Corporation	Delaware	100
OMEX Overseas Holdings Inc.	Virgin Islands	100
Zhejiang OMEX Environmental Engineering Co., Ltd.	China	100
Flexible Products Company	Georgia	100
Flexible Products Company of Canada, Inc.	Canada	100
Forbanco Inc.	Delaware	100
General Latex and Chemical Corporation	Massachusetts	100
GNS Enterprises, LLC	Georgia	100
GNS Technologies, LLC	Georgia	100
Great Western Pipeline Company, Inc.	California	100

Subsidiaries of The Dow Chemical Company **EXHIBIT 21**

At December 31, 2012

	Location*	% Ownership
This list includes companies for which the effective ownership by The Dow Chemical Company is 50 percent or more.		
GWN Holding, Inc. (31)	Delaware	61
Rohm and Haas Canada Investments Inc.	Canada	100
3243425 Nova Scotia Company	Canada	100
Daulat Canada Holding LP (77)	Canada	1
Dow Canada Holding LP (75)	Canada	1
Rohm and Haas Canada LP (54)	Canada	1
Dow Canada Holding LP (75)	Canada	99
Daulat Canada Holding LP (77)	Canada	99
3229809 Nova Scotia Company	Canada	100
Dow Investment Argentina S.A. (47)	Argentina	97
PBBPolisur S.A. (29)	Argentina	72
PBBPolisur S.A. (29)	Argentina	28
Dow Investment Argentina S.A. (47)	Argentina	3
SD Group Service Co., Ltd. (1)	Thailand	50
Siam Polyethylene Company Limited (1) (72)	Thailand	2
Siam Polyethylene Company Limited (1) (72)	Thailand	49
Dow Chemical Canada ULC	Canada	100
3229811 Nova Scotia Company	Canada	100
KDP Holding Iberoamericana, S.L.	Spain	100
3229897 Nova Scotia Company	Canada	100
Dow Chemical Finance Canada ULC	Canada	100
Fort Saskatchewan Ethylene Storage Limited Partnership (2) (13)	Canada	49
MEGlobal Canada Inc (1)	Canada	50
Pétromont and Company, Limited Partnership (1)	Canada	50
Pétromont Inc. (1)	Canada	50
Rohm and Haas Canada LP (54)	Canada	99
Ifco Inc.	Delaware	100
Chemtech II L.P. (9)	Delaware	5
Intarsia Corporation	Delaware	99
Ion Holdings LLC (16)	Delaware	60
Ion Investments S.a.r.l.	Luxembourg	100
Liana Limited (19)	Delaware	94
Dorinco Insurance (Ireland) Limited	Ireland	100
Dorinco Reinsurance Company	Michigan	100
Dorintal Reinsurance Limited	Vermont	100
100 Independence Mall West LLC	Delaware	100
Pacific Plastics (Thailand) Limited (41)	Thailand	49
Rofan Services Inc.	Delaware	100
Dow AgroSciences LLC (10)	Delaware	10
DowBrands Inc. (15)	Delaware	2
H Hotel Holding LLC	Delaware	100

Subsidiaries of The Dow Chemical Company **EXHIBIT 21**

At December 31, 2012

	Location*	% Ownership
This list includes companies for which the effective ownership by The Dow Chemical Company is 50 percent or more.		
Ion Holdings LLC (16)	Delaware	40
Liana Limited (19)	Delaware	1
Mycogen Corporation (14)	California	88
Dow AgroSciences LLC (10)	Delaware	51
Alsan Research (1)	Iowa	50
DAS Agricultural Investment Holding Company Ltd.	Mauritius	100
Dow AgroSciences India Pvt. Ltd. (28)	India	1
Dow AgroSciences (China) Company Limited	China	100
Dintec Agrichemicals LLC (1)	Delaware	50
Dow AgroSciences Agricultural Products Limited	Mauritius	100
Dow AgroSciences India Pvt. Ltd. (28)	India	99
Dow AgroSciences Singapore Pte. Ltd.	Singapore	100
Dow AgroSciences B.V.	Netherlands	100
Ambito DAS S.A. (1)	Argentina	50
Cal/West Seeds S.R.L. (24)	Argentina	99
ChacoDAS S.A. (1)	Argentina	50
DASER AGRO S.A. (1)	Argentina	50
Desab S.A. (1)	Argentina	50
Dintec Agroquimica Produtos Quimicos, Lda.	Portugal	66
Dow AgroSciences A.S.	Turkey	100
Dow AgroSciences Argentina S.A. (18)	Argentina	89
Dow AgroSciences Bolivia S.A. (32)	Bolivia	1
Dow AgroSciences Paraguay S.A. (33)	Paraguay	1
Dow AgroSciences Asia Sdn. Bhd.	Malaysia	100
Dow AgroSciences Australia Limited	Australia	100
HRZ Wheats Pty Ltd (1)	Australia	50
Dow AgroSciences Bolivia S.A. (32)	Bolivia	98
Dow AgroSciences Canada Inc.	Canada	100
Dow AgroSciences Chile S.A.	Chile	100
Dow AgroSciences Costa Rica S.A.	Costa Rica	100
Dow AgroSciences Danmark A/S	Denmark	100
Dow AgroSciences de Colombia S.A.	Colombia	100
Dow AgroSciences de Mexico S.A. de C.V.	Mexico	100
Dow AgroSciences Export S.A.S.	France	100
Dow AgroSciences Guatemala S.A.	Guatemala	100
Dow AgroSciences Iberica S.A.	Spain	100
Dow AgroSciences Industrial Ltda.	Brazil	100
Dow AgroSciences Sementes & Biotecnologia Brasil Ltda.	Brazil	100
Dow AgroSciences Limited	United Kingdom	100
Dow AgroSciences (Malaysia) Sdn Bhd	Malaysia	100
Dow AgroSciences (NZ) Limited	New Zealand	100

Subsidiaries of The Dow Chemical Company **EXHIBIT 21**

At December 31, 2012

This list includes companies for which the effective ownership by The Dow Chemical Company is 50 percent or more.

	*Location**	*% Ownership*
Dow AgroSciences OOO	Russia	100
Dow AgroSciences Pacific Limited	Hong Kong	100
Dow AgroSciences Paraguay S.A. (33)	Paraguay	99
Dow AgroSciences Bolivia S.A. (32)	Bolivia	1
Dow AgroSciences Polska Sp. z o.o.	Poland	100
Dow AgroSciences S.A.S.	France	100
Dow AgroSciences Distribution S.A.S.	France	100
Dow AgroSciences s.r.o.	Czech Republic	100
Dow AgroSciences Sverige A/B	Sweden	100
Dow AgroSciences Taiwan Ltd.	Taiwan	100
Dow AgroSciences Technology GmbH	Switzerland	100
Dow AgroSciences Switzerland S.A.	Switzerland	100
Dow AgroSciences Hungary Kft.	Hungary	100
Dow AgroSciences Vertriebsgesellschaft m.b.H.	Austria	100
Dow Brasil S.A.	Brazil	100
Branco Dow Compostos de Engenharia Ltda.	Brazil	100
Dow Especialidades Quimicas Ltda.	Brazil	100
Dow Brasil Sudeste Industrial Ltda.	Brazil	100
Dow Chemical Japan Limited	Japan	100
Dow Venezuela, C.A. (8)	Venezuela	54
Fedea S.A. (1)	Argentina	50
Forratec Argentina S.A. (1)	Argentina	50
JV Agro S.A. (1)	Argentina	50
PT Dow AgroSciences Indonesia	Indonesia	95
Rindes y Cultivos DAS S.A. (1)	Argentina	50
Terramar JV S.A. (1)	Argentina	50
Ubajay DAS S.A. (1)	Argentina	50
Dow AgroSciences China Ltd.	Delaware	100
Dow AgroSciences International Ltd.	Delaware	100
Dow AgroSciences (Thailand) Limited	Thailand	100
Dow AgroSciences Southern Africa (Proprietary) Limited	South Africa	100
Sanachem Zimbabwe (Pvt) Ltd.	Zimbabwe	100
DowBrands Inc. (15)	Delaware	11
Liana Limited (19)	Delaware	3
Mycogen Crop Protection, Inc.	California	100
Mycogen Plant Science, Inc.	Delaware	100
Agrigenetics, Inc.	Delaware	100
Agrigenetics Molokai LLC	Hawaii	100
Brodbeck Seeds LLC	Delaware	100
Cal West Seeds LLC	Delaware	100
Cal/West Seeds S.R.L. (24)	Argentina	1

Subsidiaries of The Dow Chemical Company **EXHIBIT 21**

At December 31, 2012

	*Location**	*% Ownership*
This list includes companies for which the effective ownership by The Dow Chemical Company is 50 percent or more.		
Dairyland Seed Co., Inc.	Wisconsin	100
Dow AgroSciences Argentina S.A. (18)	Argentina	11
Duo Maize B.V.	Netherlands	100
Mycogen Seeds-Puerto Rico Corporation	Delaware	100
PAGCO, Inc. (2)	Delaware	49
Pfister Seeds LLC	Delaware	100
Prairie Brand Seeds LLC	Delaware	100
Precision Soya, L.L.C. (2)	Delaware	49
Renze Seeds LLC	Delaware	100
Texas Triumph Seed Co., Inc.	Texas	100
Monterey Seed Company, Inc.	Texas	100
Phytogen Seed Company, LLC	Delaware	54
Wenben Inc.	Delaware	100
Rohm and Haas Company	Delaware	100
AgroFresh Inc.	Illinois	100
Charles Lennig & Company LLC	Delaware	100
Rohm and Haas Australia Pty. Ltd. (48)	Australia	1
Rohm and Haas Chile Limitada (49)	Chile	1
Rohm and Haas Colombia Ltda (50)	Colombia	5
Rohm and Haas Argentina S.R.L. (51)	Argentina	10
Rohm and Haas Australia Pty. Ltd. (48)	Australia	99
Rohm and Has Centro America, S.A.	Costa Rica	100
Rohm and Haas Chemicals LLC (52)	Delaware	23
CVD Incorporated	Delaware	100
Morton Intermediate Company	Delaware	100
Rohm and Haas Electronic Materials Taiwan Ltd.	Taiwan	100
Morton International Co., Ltd.	Japan	100
Morton International, LLC	Indiana	100
Nichigo-Morton Co., Ltd. (1)	Japan	50
Rohm and Haas Credit LLC	Delaware	100
Rohm and Haas Capital Corporation	Delaware	100
Rohm and Haas Equity Corporation (53)	Delaware	83
GWN Holding, Inc. (31)	Delaware	8
ROH Venture GmbH	Germany	100
StoHaas Management GmbH (1)	Germany	50
StoHaas Monomer GmbH & Co. KG (1)	Germany	50
Rohm and Haas (Far East) Limited	Hong Kong	100
Rohm and Haas Asia, Inc.	Delaware	100
Rohm and Haas Chemical (Thailand) Limited	Thailand	100
Rohm and Haas China, Inc.	Delaware	100
Beijing Eastern Rohm and Haas Company Limited	China	60

Subsidiaries of The Dow Chemical Company

At December 31, 2012

EXHIBIT 21

	Location*	% Ownership
This list includes companies for which the effective ownership by The Dow Chemical Company is 50 percent or more.		
Rohm and Haas Shanghai Technical Service and Consulting Company Limited	China	99
Rohm and Haas International Trading (Shanghai) Co. Ltd.	China	100
Shanghai Eastern Rohm and Haas Company Ltd.	China	59
Rohm and Haas Denmark Investments LLC	Delaware	100
Rohm and Haas European Holding ApS (56)	Denmark	1
Rohm and Haas Denmark A/S	Denmark	100
Rohm and Haas Denmark Finance A/S	Denmark	100
DC Spectrum Holding C.V. (38)	Netherlands	1
PT Rohm and Haas Indonesia (58)	Indonesia	99
RH DK ChemiHaas Holding ApS	Denmark	100
RH DK Korea FPD Holdings ApS	Denmark	100
SKC Haas Display Films Co., Ltd.	Korea	51
SKC Haas Display Films (USA) LLC	Delaware	100
SKC Haas Display Films Japan K.K.	Japan	100
SKC Haas Display Films Taiwan Ltd.	Taiwan	100
SKC Haas Polska Sp. z o.o.	Poland	100
SKC New Material (Suzhou) Co., Ltd.	China	100
RH DK Korea OLED Holdings ApS	Denmark	100
Dow Chemical OLED Ltd. (78)	Korea	27
Rohm and Haas Electronic Materials Korea Ltd. (79)	Korea	27
RH DK Mexico Holding ApS	Denmark	100
Rohm and Haas Mexico, S. de R.L. de C.V. (59)	Mexico	99
RH DK Vietnam Holdings ApS	Denmark	100
Rohm and Haas Vietnam Co., Ltd.	Vietnam	100
Rohm and Haas (India) Pvt. Ltd. (57)	India	1
Rohm and Haas Argentina S.R.L. (51)	Argentina	90
Rohm and Haas Asia (Sanshui) Specialty Coatings Investment ApS	Denmark	100
Rohm and Haas (Foshan) Specialty Materials Co., Ltd.	China	100
Rohm and Haas Chemicals Singapore Pte. Ltd.	Singapore	100
Rohm and Haas China Holding ApS	Denmark	100
Rohm and Haas (China) Holding Co., Ltd.	China	100
Rohm and Haas China Investment Holding Company Ltd	Mauritius	100
Rohm and Haas Denmark Bermuda Holding Company ApS	Denmark	100
DC Spectrum Holding C.V. (38)	Netherlands	1
RH Asia Holding GmbH	Switzerland	100
Rohm and Haas Electronic Materials Asia Limited	Hong Kong	100
RH Denmark Dongguan Holding Company ApS	Denmark	100
Rohm and Haas Electronic Materials (Shanghai) Ltd.	China	100
Rohm and Haas Electronic Materials Singapore Pte. Ltd. (68)	Singapore	50
Rohm and Haas Electronic Materials Singapore Pte. Ltd. (68)	Singapore	50
Rohm and Haas Denmark China Investment ApS	Denmark	100

Subsidiaries of The Dow Chemical Company **EXHIBIT 21**

At December 31, 2012

	*Location**	*% Ownership*
This list includes companies for which the effective ownership by The Dow Chemical Company is 50 percent or more.		
PT Rohm and Haas Indonesia (58)	Indonesia	1
Rohm and Haas Bermuda Partner I GP (60)	Bermuda	1
Rohm and Haas Bermuda Partner II GP (67)	Bermuda	1
Rohm and Haas Latinoamerica, S. de R.L. de C.V. (69)	Mexico	1
Rohm and Haas Mexico, S. de R.L. de C.V. (59)	Mexico	1
Rohm and Haas Shanghai Chemical Industry Co., Ltd.	China	100
Rohm and Haas HK Dongguan Holding Limited	Hong Kong	100
Rohm and Haas Electronic Materials (Dongguan) Co., Ltd.	China	100
Rohm and Haas India Investment ApS	Denmark	100
Rohm and Haas (India) Pvt. Ltd. (57)	India	99
Rohm and Haas Kimya Sanayi Limited Sirketi (63)	Turkey	1
Rohm and Haas Kimya Ticaret Limited Sirketi (64)	Turkey	1
Rohm and Haas Kimyasal Urunler Uretim Dagitim ve Ticaret A.S. (65)	Turkey	1
Rohm and Haas Latinoamerica, S. de R.L. de C.V. (69)	Mexico	99
Rohm and Haas Singapore (Pte.) Ltd.	Singapore	100
Rohm and Haas European Holding ApS (56)	Denmark	99
Rohm and Haas Korea Co., Ltd.	Korea	100
Rohm and Haas Malaysia Sdn Bhd	Malaysia	100
Rohm and Haas Texas Incorporated	Texas	100
Battleground Water Company (70)	Texas	52
ROH Monomer Holding Company	Delaware	100
Rohm and Haas Investment Holdings Inc. (55)	Delaware	30
Rohm and Haas Equity Corporation (53)	Delaware	12
Rohm and Haas Wood Treatment LLC	Delaware	100
Rohm and Haas Chile Limitada. (49)	Chile	99
Rohm and Haas Colombia Ltda (50)	Colombia	95
Rohm and Haas de Venezuela, C.A.	Venezuela	100
Rohm and Haas Electronic Materials K.K.	Japan	100
LeaRonal Japan Y.K.	Japan	100
Rohm and Haas Japan Kabushiki Kaisha	Japan	100
Japan Acrylic Chemical Co., Ltd.	Japan	100
Rohm and Haas Equity Corporation (53)	Delaware	2
Rohm and Haas Holdings LLC	Delaware	100
Rohm and Haas Chemicals LLC (52)	Delaware	76
Rohm and Haas Electronic Materials Holdings, Inc.	Delaware	100
Rohm and Haas Electronic Materials CMP Inc.	Delaware	100
Rohm and Haas Electronic Materials CMP Asia Inc.	Delaware	80
Nitta Haas Trading Company	Japan	100
Rohm and Haas Electronic Materials CMP Korea Ltd.	Korea	100
Rohm and Haas Electronic Materials CMP Sdn. Bhd.	Malaysia	100
Rohm and Haas Electronic Materials CMP Holdings, Inc.	Delaware	100

Subsidiaries of The Dow Chemical Company **EXHIBIT 21**

At December 31, 2012

	*Location**	*% Ownership*
This list includes companies for which the effective ownership by The Dow Chemical Company is 50 percent or more.		
Rohm and Haas International Holdings Inc.	Delaware	100
Rohm and Haas Asia Holdings B.V.	Netherlands	100
Dow Chemical OLED Ltd. (78)	Korea	73
Rohm and Haas Electronic Materials Asia-Pacific Co., Ltd.	Taiwan	100
Rohm and Haas Electronic Materials Korea Ltd. (79)	Korea	73
Rohm and Haas Japan Holdings Y.K.	Japan	100
Nitta Haas Incorporated (2)	Japan	50
Rodel Particles, Inc. (80)	Japan	100
Rohm and Haas Taiwan, Inc.	Taiwan	100
Rohm and Haas Electronic Materials LLC	Delaware	100
Lightscape Materials, Inc.	Delaware	100
Shanghai Lightscape Specialty Materials Co. Ltd.	China	100
Rohm and Haas Equity Corporation (53)	Delaware	3
Rohm and Haas Latin America, Inc.	Delaware	100
Rohm and Haas Chemicals LLC (52)	Delaware	1
Rohm and Haas Investment Holdings Inc. (55)	Delaware	70
Rohm and Haas New Zealand Limited	New Zealand	100
Rohm and Haas Philippines, Inc.	Philippines	100
Rohm and Haas Quimica Ltda.	Brazil	100
Rohm and Haas Southeast Asia, Inc.	Delaware	100
SAFECHEM North America LLC	Delaware	100
Sentrachem US, Inc.	Delaware	100
Hampshire Holdings, Inc.	Delaware	100
Hampshire Chemical Corp.	Delaware	100
Siam Polystyrene Company Limited (1)	Thailand	50
Siam Styrene Monomer Co., Ltd. (1)	Thailand	50
Siam Synthetic Latex Company Limited (1)	Thailand	50
Styron Asia Limited	Hong Kong	100
TCM Technologies Inc.	Delaware	100
Texas LNG Holdings LLC	Delaware	100
Union Carbide Corporation	New York	100
Amerchol Corporation	Delaware	100
Benefit Capital Management Corporation	Delaware	100
Calidria Corporation	Delaware	100
Carbide Chemical (Thailand) Limited	Thailand	100
Catalysts, Adsorbents & Process Systems, Inc.	Maryland	100
Dow International Holdings Company (23)	Delaware	19
Dow Quimica Argentina S.A. (21)	Argentina	23
Dow Quimica Mexicana S.A. de C.V. (17)	Mexico	15
Global Industrial Corporation	New York	100
GWN Holding, Inc. (31)	Delaware	6

	Location*	% Ownership
This list includes companies for which the effective ownership by The Dow Chemical Company is 50 percent or more.		
Industrias Carlisil, S.A.	Mexico	100
Nippon Unicar Company Limited (1)	Japan	50
Peñuelas Technology Park LLC	Delaware	100
Seadrift Pipeline Corporation	Delaware	100
Servicios de Quimicos Agricolas, S. A.	Mexico	100
South Charleston Sewage Treatment Company	West Virginia	100
UC Finco Inc.	Delaware	100
UCAR Emulsion Systems International, Inc.	Delaware	100
UCAR Emulsion Systems FZE	Dubai	100
UCAR Interam Inc.	Delaware	100
UCAR Louisiana Pipeline Company	Delaware	100
UCAR Pipeline Incorporated	Delaware	100
UCMG LLC	Delaware	100
Umetco Minerals Corporation	Delaware	100
Australia and New Zealand Exploration Company	Delaware	100
Blue Creek Coal Company, Inc.	Delaware	100
Predate Properties (Pty) Ltd.	South Africa	100
Umetco Minerals Exploration Corporation	Delaware	100
Union Carbide Asia Limited	Hong Kong	100
Union Carbide (Guangdong Zhongshan) Company Limited	China	75
Union Carbide Asia Pacific, Inc.	Delaware	100
Union Carbide Chemicals & Plastics Technology LLC	Delaware	100
Dow Technology Investments LLC (37)	Delaware	50
Union Carbide Customer Services Pte. Ltd.	Singapore	100
Union Carbide Ethylene Oxide/Glycol Company	Delaware	100
Union Carbide Inter-America, Inc.	Delaware	100
Dow Peru S.A. (25)	Peru	9
Dow Quimica Chilena S.A. (22)	Chile	10
Union Carbide Middle East Limited	Delaware	100
Union Carbide Pan America, Inc.	Delaware	100
Dow Quimica Argentina S.A. (21)	Argentina	1
Dow Quimica Chilena S.A. (22)	Chile	1
Union Carbide Philippines (Far East), Inc.	Philippines	100
Union Carbide Polyolefins Development Company, Inc.	Delaware	100
Union Carbide South Africa (Proprietary) Limited	South Africa	100
Union Carbide Subsidiary C, Inc.	Delaware	100
Univation Technologies, LLC (1)	Delaware	50
Union Carbide Subsidiary Q Inc.	Delaware	100
Union Carbide Wire & Cable Company, Inc.	Delaware	100
Union Polymers Sdn. Bhd.	Malaysia	90
UNISON Transformer Services, Inc.	Delaware	100

EXHIBIT 21

Subsidiaries of The Dow Chemical Company
At December 31, 2012

	*Location**	*% Ownership*
This list includes companies for which the effective ownership by The Dow Chemical Company is 50 percent or more.		
Westbridge Insurance Ltd.	Bermuda	100
U.S. Laboratories, Inc.	Ohio	100
Administrative Business Systems, Inc.	Ohio	100
POLY-CARB, Inc.	Ohio	100
Warbler I LLC	Delaware	100

*Location of incorporation or organization. Primary location of organization is reported for partnerships.

(1) These companies are 50%-owned, nonconsolidated affiliates of The Dow Chemical Company and are accounted for on the equity basis. Separate financial statements for these companies are not included in this Annual Report on Form 10-K. These companies are not controlled, directly or indirectly, by The Dow Chemical Company. Subsidiaries of these companies, if any, are not listed in this Exhibit 21.

(2) These companies are 20-50%-owned, consolidated affiliates of The Dow Chemical Company. Subsidiaries of these companies, if any, are not listed in this Exhibit 21.

(3) Dow Corning Corporation is a 50%-owned, nonconsolidated affiliate of The Dow Chemical Company and is accounted for on the equity basis. As a significant subsidiary, separate financial statements for Dow Corning Corporation are presented in this Annual Report on Form 10-K pursuant to Rule 3-09 of Regulation S-X. Subsidiaries of Dow Corning Corporation, if any, are not listed in this Exhibit 21.

(4) The Dow Chemical Company effective ownership of Dow Mideast Systems S.A.E. (JSC) is 100% of which Dow Europe Holding B.V. owns 99.96%, Dow Europe GmbH owns 0.020% and Dow InterBranch B.V. owns 0.020%.

(5) The Dow Chemical Company effective ownership of Dow Turkiye Kimya Sanayi ve Ticaret Ltd Sirketi is 100% of which Dow Europe Holding B.V. owns 99.9988% and Dow InterBranch B.V. owns 0.0012%.

(6) The Dow Chemical Company effective ownership of Dow Quimica de Colombia S.A. is 100% of which The Dow Chemical Company owns 90% and Dow Chemical Inter-American Limited owns 10%.

(7) The Dow Chemical Company effective ownership of DowBrands L.P. is 100% of which Dow Holdings LLC owns 58% and DC Partnership Management Inc. owns 42%.

(8) The Dow Chemical Company effective ownership of Dow Venezuela, C.A. is 100% of which Dow AgroSciences B.V. owns 53.84% and The Dow Chemical Company owns 46.16%.

(9) The Dow Chemical Company effective ownership of Chemtech II L.P. is 100% of which Dow Chemical Delaware Corp. owns 72.46%, The Dow Chemical Company owns 22.39% and Ifco Inc. owns 5.15%.

(10) The Dow Chemical Company effective ownership of Dow AgroSciences LLC is 100% of which Mycogen Corporation owns 51%, Centen Ag Inc. owns 38.91% and Rofan Services Inc. owns 10.09%.

(11) The Dow Chemical Company effective ownership of Polyol Belgium B.V.B.A. is 100% of which Dow Benelux B.V. owns 99.5% and Dow Europe Holding B.V. owns 0.5%.

(12) The Dow Chemical Company effective ownership of Chemtech Portfolio Inc. is 100% of which Dow Global Technologies LLC owns 66.82% and Chemtech II L.P. owns 33.18%.

(13) The Dow Chemical Company effective ownership of Fort Saskatchewan Ethylene Storage Limited Partnership is 50% of which Dow Chemical Canada ULC owns 49.9% and Fort Saskatchewan Ethylene Storage Corporation owns 0.2%. (Midland Pipeline Corp. owns 50% of Fort Saskatchewan Ethylene Storage Corporation.)

(14) The Dow Chemical Company effective ownership of Mycogen Corporation is 100% of which Rofan Services Inc. owns 88.11% and Centen Ag Inc. owns 11.89%.

(15) The Dow Chemical Company effective ownership of DowBrands Inc. is 100% of which Dow International Holdings Company owns 79%, Mycogen Corporation owns 11%, Centen Ag Inc. owns 8% and Rofan Services Inc. owns 2%.

(16) The Dow Chemical Company effective ownership of Ion Holdings LLC is 100% of which The Dow Chemical Company owns 60% and Rofan Services Inc. owns 40%.

(17) The Dow Chemical Company effective ownership of Dow Quimica Mexicana S.A. de C.V. is 100% of which The Dow Chemical Company owns 84.58% and Union Carbide Corporation owns 15.42%.

(18) The Dow Chemical Company effective ownership of Dow AgroSciences Argentina S.A. is 100% of which Dow AgroSciences B.V. owns 89.13% and Agrigenetics, Inc. owns 10.87%.

(19) The Dow Chemical Company effective ownership of Liana Limited is 100% of which The Dow Chemical Company owns 93.985%, Mycogen Corporation owns 3.0075%, Centen Ag Inc. owns 2.4436% and Rofan Services Inc. owns 0.5639%.

(20) The Dow Chemical Company effective ownership of Dow Zwijndrecht B.V.B.A. is 100% of which Dow Europe Holding B.V. owns 99.65% and Dow InterBranch B.V. owns 0.35%.

(21) The Dow Chemical Company effective ownership of Dow Quimica Argentina S.A. is 100% of which The Dow Chemical Company owns 76.70%, Union Carbide Corporation owns 23.20% and Union Carbide Pan America, Inc. owns 0.10%.

(22) The Dow Chemical Company effective ownership of Dow Quimica Chilena S.A. is 100% of which The Dow Chemical Company owns 89.81%, Union Carbide Inter-America, Inc. owns 10.16% and Union Carbide Pan America, Inc. owns 0.03%.

(23) The Dow Chemical Company effective ownership of Dow International Holdings Company is 100% of which The Dow Chemical Company owns 72.0268%, Union Carbide Corporation owns 19.1341%, Essex Specialty Products LLC owns 8.7988% and Dow Chemical International Ltd owns 0.0403%.

(24) The Dow Chemical Company effective ownership of Cal/West Seeds S.R.L. is 100% of which Dow AgroSciences B.V. owns 99.1869% and Agrigenetics, Inc. owns 0.8131%.

(25) The Dow Chemical Company effective ownership of Dow Peru S.A. is 100% of which The Dow Chemical Company owns 91.2076% and Union Carbide Inter-America, Inc. owns 8.7924%.

(26) The Dow Chemical Company effective ownership of Valuepark Terneuzen C.V. is 50% of which Terneuzen Partnership Services B.V. owns 49.8172% and Valuepark Terneuzen Beheer B.V. owns 0.3656%. (Dow Benelux B.V. owns 50% of Valuepark Terneuzen Beheer BV).

(27) The Dow Chemical Company effective ownership of Dow Chemical International Pvt. Ltd. is 100% of which Dow Chemical Pacific (Singapore) Private Limited owns 99.99% and Dow Chemical (Singapore) Private Limited owns 0.01%.

(28) The Dow Chemical Company effective ownership of Dow AgroSciences India Pvt. Ltd. is 100% of which Dow AgroSciences Agricultural Products Limited owns 99.99% and DAS Agricultural Investment Holding Company Ltd. owns 0.01%.

(29) The Dow Chemical Company effective ownership of PBBPolisur S.A. is 100% of which Dow Investment Argentina S.A. owns 72% and 3229809 Nova Scotia Company owns 28%.

(30) The Dow Chemical Company effective ownership of Dow Stade Produktions GmbH & Co. OHG is 100% of which SAFECHEM Europe GmbH owns 70% and ANGUS Chemie GmbH owns 30%. Dow Europe Holding B.V acts as a general partner with 0% capital participation.

(31) The Dow Chemical Company effective ownership of GWN Holding, Inc. is 100% of which The Dow Chemical Company owns 60.7324%, Essex Specialty Products LLC owns 24.6760%, Rohm and Haas Equity Corporation owns 8.2817% and Union Carbide Corporation owns 6.3099%.

(32) The Dow Chemical Company effective ownership of Dow AgroSciences Bolivia S.A. is 100% of which Dow AgroSciences B.V. owns 99%, Dow AgroSciences Argentina S.A. owns 0.5% and Dow AgroSciences Paraguay S.A. owns 0.5%.

(33) The Dow Chemical Company effective ownership of Dow AgroSciences Paraguay S.A. is 100% of which Dow AgroSciences B.V. owns 99.99% and Dow AgroSciences Argentina S.A. owns 0.01%.

(34) The Dow Chemical Company effective ownership of Dow Chemical Korea Limited is 100% of which The Dow Chemical Company owns 85.82% and Dow Europe Holding B.V. owns 14.18%.

(35) The Dow Chemical Company effective ownership of Dow Saudi Arabia Company is 100% of which Dow Europe Holding B.V. owns 85% and Dow Interbranch B.V. owns 15%.

(36) The Dow Chemical Company effective ownership of Dow Wolff Cellulosics GmbH & Co. OHG is 100% of which ANGUS Chemie GmbH owns 50% and SAFECHEM Europe GmbH owns 50%. Dow Europe Holding B.V. acts as general partner with 0% capital participation.

(37) The Dow Chemical Company effective ownership of Dow Technology Investments LLC is 100% of which Dow Global Technologies LLC owns 50% and Union Carbide Chemicals & Plastics Technology LLC owns 50%.

(38) The Dow Chemical Company effective ownership of DC Spectrum Holding C.V. is 100% of which Dow International Holdings Company owns 99.31510%, Rohm and Haas Denmark Finance A/S owns 0.54014%, Rohm and Haas Denmark Bermuda Holding Company ApS owns 0.14476% and Dow Netherlands Holdings LLC owns a nominal percentage.

(39) The Dow Chemical Company effective ownership of Coöperatieve DC Prisma Holding U.A. is 100% of which DC Spectrum Holding C.V. owns 99.999% and Dow Netherlands Investments LLC owns .001%.

(40) The Dow Chemical Company effective ownership of DC Galaxy Holding C.V. is 100% of which Dow International Holdings S.A. owns 99.928% and Dow Dutch Holding B.V. owns 0.072%.

(41) The Dow Chemical Company effective ownership of Pacific Plastics (Thailand) Limited is 100% of which Dow Chemical International Ltd. owns 51% and The Dow Chemical Company owns 49%.

(42) The Dow Chemical Company effective ownership of Dow Egypt Services Limited is 100% of which Dow Mideast Systems S.A.E. (JSC) owns 75% and Dow Europe GmbH owns 25%.

(43) The Dow Chemical Company effective ownership of Dow Olefinverbund GmbH is 100% of which Dow Europe Holding B.V. owns 94.7619% and Dow Beteiligungsgesellschaft mbH & Co. KG owns 5.2381%.

(44) The Dow Chemical Company effective ownership of Dow Izolan OOO is 58% via its ownership interest in RUS Polyurethanes Holding B.V.

(45) The Dow Chemical Company effective ownership of Dow Izolan Ukraine LLC is 58% via its ownership interest in RUS Polyurethanes Holding B.V.

(46) The Dow Chemical Company effective ownership of Dow Bahrain Holding W.L.L. is 100% of which Dow Europe Holding B.V. owns 90% and Dow InterBranch B.V. owns 10%.

(47) The Dow Chemical Company effective ownership of Dow Investment Argentina S.A. is 100% of which 3229809 Nova Scotia Company owns 97% and Daulat Canada Holding LP owns 3%.

(48) The Dow Chemical Company effective ownership of Rohm and Haas Australia Pty. Ltd. is 100% of which Rohm and Haas Company owns 99.9999% and Charles Lennig & Company LLC owns .0001%.

(49) The Dow Chemical Company effective ownership of Rohm and Haas Chile Limitada is 100% of which Rohm and Haas Company owns 99% and Charles Lennig & Company LLC owns 1%.

(50) The Dow Chemical Company effective ownership of Rohm and Haas Colombia Ltda is 100% of which Rohm and Haas Company owns 94.8999% and Charles Lennig & Company LLC owns 5.1001%.

(51) The Dow Chemical Company effective ownership of Rohm and Haas Argentina S.R.L. is 100% of which Rohm and Haas Denmark Finance A/S owns 89.9942% and Rohm and Haas Company owns 10.0058%.

(52) The Dow Chemical Company effective ownership of Rohm and Haas Chemicals LLC is 100% of which Rohm and Haas Holdings LLC owns 76.80153%, Rohm and Haas Company owns 23.13014% and Rohm and Haas Latin America, Inc. owns .06833%.

(53) The Dow Chemical Company effective ownership of Rohm and Haas Equity Corporation is 100% of which Rohm and Haas Credit LLC owns 82.731264%, Rohm and Haas Chemicals LLC owns 12.666042%, Rohm and Haas Electronic Materials LLC owns 3.031015% and Rohm and Haas Company owns 1.571679%.

(54) The Dow Chemical Company effective ownership of Rohm and Haas Canada LP is 100% of which Rohm and Haas Canada Investments Inc. owns 99.9998% and 3243425 Nova Scotia Company owns .0002%.

(55) The Dow Chemical Company effective ownership of Rohm and Haas Investments Holdings Inc. is 100% of which Rohm and Haas Company owns 70% and Rohm and Haas Texas Incorporated owns 30%.

(56) The Dow Chemical Company effective ownership of Rohm and Haas European Holding ApS is 100% of which Rohm and Haas Equity Corporation owns 99.999347% and Rohm and Haas Denmark Investments LLC owns .000653%.

(57) The Dow Chemical Company effective ownership of Rohm and Haas (India) Pvt. Ltd. is 100% of which Rohm and Haas India Investment ApS owns 99.9985% and Rohm and Haas Denmark Finance A/S owns .0015%.

(58) The Dow Chemical Company effective ownership of PT Rohm and Haas Indonesia is 100% of which Rohm and Haas Denmark Finance A/S owns 99% and Rohm and Haas Denmark China Investment ApS is 1%.

(59) The Dow Chemical Company effective ownership Rohm and Haas Mexico, S. de R.L. de C.V. is 100% of which RH DK Mexico Holding ApS owns 99.97% and Rohm and Haas Denmark China Investment ApS owns .03%.

(60) The Dow Chemical Company effective ownership of Rohm and Haas Bermuda Partner I GP is 100% of which Dow Europe Holding B.V. owns 99.9999% and Rohm and Haas Denmark China ApS owns .0001%.

(61) The Dow Chemical Company effective ownership of Rohm and Haas Bermuda GP is 100% of which Rohm and Haas Bermuda Partner II GP owns 52.80% and Rohm and Haas Denmark Bermuda GP ApS owns 47.20%.

(62) The Dow Chemical Company effective ownership of PT Dow Indonesia is 100% of which Dow Chemical Pacific (Singapore) Private Limited owns 99% and Dow Chemical (Singapore) Private Limited owns 1%.

(63) The Dow Chemical Company effective ownership of Rohm and Haas Kimya Sanayi Limited Sirketi is 100% of which Rohm and Haas Denmark Holding Company ApS owns 99.9992% and Rohm and Haas Denmark Finance A/S owns .0008%.

(64) The Dow Chemical Company effective ownership of Rohm and Haas Kimya Ticaret Limited Sirketi is 100% of which Rohm and Haas Denmark Holding Company ApS owns 99.9999% and Rohm and Haas Denmark Finance A/S owns .0001%.

(65) The Dow Chemical Company effective ownership of Rohm and Haas Kimyasal Urunler Uretim Dagitim ve Ticaret A.S. is 60% of which Rohm and Haas Denmark Holding Company ApS owns 59.9993% and Rohm and Haas Denmark Finance A/S owns .0007%.

(66) The Dow Chemical Company effective ownership of Rohm and Haas International SNC is 100% of which Rohm and Haas Denmark Holding Company ApS owns 99.9999% and Rohm and Haas Europe Sales ApS owns .0001%.

(67) The Dow Chemical Company effective ownership of Rohm and Haas Bermuda Partner II GP is 100% of which Dow Europe Holding B.V. owns 99.9999% and Rohm and Haas Denmark China Investment ApS owns .0001%.

(68) The Dow Chemical Company effective ownership of Rohm and Haas Electronic Materials Singapore Pte. Ltd. is 100% of which Rohm and Haas Electronic Materials Asia Limited owns 50% and RH Asia Holding GmbH owns 50%.

(69) The Dow Chemical Company effective ownership of Rohm and Haas Latinoamerica, S. DE R.L. DE C.V. is 100% of which Rohm and Haas Denmark Finance A/S owns 99.9999% and Rohm and Haas Denmark China Investment ApS owns .0001%.

(70) The Dow Chemical Company effective ownership of Battleground Water Company is 60.61% of which Rohm and Haas Texas Incorporated owns 51.77% and The Dow Chemical Company owns 8.84%.

(71) The Dow Chemical Company effective ownership of Dow MF Produktion GmbH & Co. OHG is 100% of which SAFECHEM Europe GmbH owns 70% and Dow MF Verwaltungs GmbH owns 30%. Dow Europe Holding B.V. acts as a general partner with 0% capital participation.

(72) The Dow Chemical Company effective ownership of Siam Polyethylene Company Limited is 50% of which Daulat Canada Holding LP owns 49% and SD Group Service Co. Ltd., which is 50%-owned by The Dow Chemical Company, owns 2%.

(73) The Dow Chemical Company effective ownership of Dow Deutschland Vertriebs GmbH & Co. OHG is 100% of which SAFECHEM Europe GmbH owns 70% and Dow Deutschland Verwaltungs Vertriebs GmbH owns 30%. Dow Europe Holding B.V. acts as a general partner with 0% capital participation.

(74) The Dow Chemical Company effective ownership of Dow International Holdings S.A. is 100% of which Dow Dutch Holding B.V. owns 99.7444% and Dow Chemical International Ltd. owns 0.2556%.

(75) The Dow Chemical Company effective ownership of Dow Canada Holding LP is 100% of which Rohm and Haas Canada Investments Inc. owns 99.9999% and 3243425 Nova Scotia Company owns 0.0001%.

(76) The Dow Chemical Company effective ownership of Dow Chemical East Africa Limited is 100% of which Dow Europe Holding B.V. owns 90% and Dow InterBranch B.V. owns 10%.

(77) The Dow Chemical Company effective ownership of Daulat Canada Holding LP is 100% of which Dow Canada Holding LP owns 99.9999% and 3243425 Nova Scotia Company owns 0.0001%.

(78) The Dow Chemical Company effective ownership of Dow Chemical OLED Ltd. is 100% of which Rohm and Haas Asia Holdings B.V. owns 73.22% and RH DK Korea OLED Holdings ApS owns 26.78%.

(79) The Dow Chemical Company effective ownership of Rohm and Haas Electronic Materials Korea Ltd. is 100% of which Rohm and Haas Asia Holdings B.V. owns 73.22% and RH DK Korea OLED Holdings ApS owns 26.78%.

(80) The Dow Chemical Company effective ownership of Rodel Particles, Inc. is 50% via its ownership interest in Nitta Haas Incorporated.

New Jersey Business Gateway
Business Entity Information and Records Service
Business Id : 0600059971

Status Report For:	DURAPORT REALTY ONE, LLC
Report Date:	4/29/2013
Confirmation Number:	3119272059

IDENTIFICATION NUMBER, ENTITY TYPE AND STATUS INFORMATION

Business ID Number:	0600059971
Business Type:	DOMESTIC LIMITED LIABILITY COMPANY
Status:	ACTIVE
Original Filing Date:	12/14/1998
Stock Amount:	N/A
Home Jurisdiction:	NJ
Status Change Date:	NOT APPLICABLE

REVOCATION/SUSPENSION INFORMATION

DOR Suspension Start Date:	N/A
DOR Suspension End Date:	N/A
Tax Suspension Start Date:	N/A
Tax Suspension End Date:	N/A

ANNUAL REPORT INFORMATION

Annual Report Month:	DECEMBER
Last Annual Report Filed:	11/04/2012
Year:	2012

AGENT/SERVICE OF PROCESS (SOP)INFORMATION

Agent:	VINCENT ALESSI
Agent/SOP Address:	160 EAST 22ND STREET PO BOX 1009,BAYONNE,NJ,07002 0000
Address Status:	DELIVERABLE
Main Business Address:	85 EAST 2ND STPO BOX 1009,BAYONNE,NJ,07002
Principal Business Address:	85 EAST 2ND STPO BOX 1009,BAYONNE,NJ,07002

ASSOCIATED NAMES

Associated Name:	N/A
Type:	N/A

PRINCIPALS

Following are the most recently reported officers/directors (corporations), managers/members/managing members (LLCs), general partners (LPs), trustees/officers (non-profits).

Title:	MANAGING MEMBER
Name:	ALESSI,VINCENT
Address:	85 EAST 2ND ST ,BAYONNE,NJ 07002

FILING HISTORY -- CORPORATIONS, LIMITED LIABILITY COMPANIES, LIMITED PARTNERSHIPS AND LIMITED LIABILITY PARTNERSHIPS

To order copies of any of the filings below, return to the service page, https://www.njportal.com/DOR/businessrecords/Default.aspx and follow the instructions for obtaining copies. Please note that trade names are filed initially with the County Clerk(s) and are not available through this service. Contact the Division for instructions on how to order Trade Mark documents.

Charter Documents for Corporations, LLCs, LPs and LLPs

Original Filing (Certificate)Date:	1998

Changes and Amendments to the Original Certificate:

Filing Type	Year Filed
CHANGE OF AGENT AND OFFICE	2000

Note:
Copies of some of the charter documents above, particularly those filed before August 1988 and recently filed documents (filed less than 20 work days from the current date), may not be available for online download.

- For older filings, contact the Division for instructions on how to order.

New Jersey Business Gateway
Business Entity Information and Records Service
Business Id : 0600059971

- For recent filings, allow 20 work days from the estimated filing date, revisit the service center at https://www.njportal.com/DOR/businessrecords/Default.aspx periodically, search for the business again and build a current list of its filings. Repeat this procedure until the document shows on the list of documents available for download.

The Division cannot provide information on filing requests that are in process. Only officially filed documents are available for download.

New Jersey Business Gateway
Business Entity Information and Records Service
Business Id : 0600059972

Status Report For:	DURAPORT REALTY TWO, LLC
Report Date:	4/29/2013
Confirmation Number:	3119272059

IDENTIFICATION NUMBER, ENTITY TYPE AND STATUS INFORMATION

Business ID Number:	0600059972
Business Type:	DOMESTIC LIMITED LIABILITY COMPANY
Status:	ACTIVE
Original Filing Date:	12/14/1998
Stock Amount:	N/A
Home Jurisdiction:	NJ
Status Change Date:	NOT APPLICABLE

REVOCATION/SUSPENSION INFORMATION

DOR Suspension Start Date:	N/A
DOR Suspension End Date:	N/A
Tax Suspension Start Date:	N/A
Tax Suspension End Date:	N/A

ANNUAL REPORT INFORMATION

Annual Report Month:	DECEMBER
Last Annual Report Filed:	11/04/2012
Year:	2012

AGENT/SERVICE OF PROCESS (SOP)INFORMATION

Agent:	VINCENT ALESSI
Agent/SOP Address:	160 EAST 22ND STREET PO BOX 1009,BAYONNE,NJ,07002 0000
Address Status:	DELIVERABLE
Main Business Address:	85 EAST 2ND ST,BAYONNE,NJ,07002
Principal Business Address:	85 EAST 2ND STPO BOX 1009,BAYONNE,NJ,07002

ASSOCIATED NAMES

Associated Name:	N/A
Type:	N/A

New Jersey Business Gateway
Business Entity Information and Records Service
Business Id : 0600059972

PRINCIPALS

Following are the most recently reported officers/directors (corporations), managers/members/managing members (LLCs), general partners (LPs), trustees/officers (non-profits).

Title:	MANAGING MEMBER
Name:	ALESSI,VINCENT
Address:	85 EAST 2ND ST ,BAYONNE,NJ 07002

FILING HISTORY -- CORPORATIONS, LIMITED LIABILITY COMPANIES, LIMITED PARTNERSHIPS AND LIMITED LIABILITY PARTNERSHIPS

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Original Filing (Certificate)Date:	1998

Changes and Amendments to the Original Certificate:

Filing Type	Year Filed
CHANGE OF AGENT AND OFFICE	2000

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New Jersey Business Gateway
Business Entity Information and Records Service
Business Id : 0600059972

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The Division cannot provide information on filing requests that are in process. Only officially filed documents are available for download.

STATE OF NEW JERSEY)
: ss.:
COUNTY OF ESSEX)

David Rauch, of full age, being duly sworn according to law, upon his oath deposes and says:

1. I am the President and sole officer of Flexon Industries Corp. and I have personal knowledge of the facts set forth in this affidavit.

2. Flexon Industries Corp. is a New Jersey Corporation with a mailing address of 366 Frelinghuysen Avenue, Newark, New Jersey.

3. Flexon Industries Corp. is an inactive entity without presiding officers or board members.

4. Flexon Industries Corp. is not an operating entity, is not a subsidiary or affiliate of another company, it has no subsidiaries and it is not a successor to another company.

5. Flexon Industries Corp. has no employees.

6. Flexon Industries Corp. does not have cash flow or income and has no liquid assets.

7. Flexon Industries Corp. does not prepare financial statements.

8. Flexon Industries Corp. searched its records for insurance policies but was unable to locate any policy information. Additionally, Flexon Industries Corp. contacted its insurance broker and insurance consultant in search of insurance information but was unsuccessful in locating any policy information. Finally, Flexon Industries Corp. contacted counsel who handled unrelated insurance coverage matters on its behalf but these efforts

similarly have not yielded any insurance information.

9. Flexon Industries Corp. has no indemnification agreements or potential contribution actions.

I certify that the foregoing statements made by me are true.

David Rauch

Sworn and subscribed before me on this
27th day of May, 2011

Notary Public

SEEBARRAT POORAN
Notary Public - State of New York
NO. 01PO4934689
Qualified in Kings County
My Commission Expires 6/20/2014

1548214

STATE OF	NEW JERSEY	)	
		:	ss.:
COUNTY OF	ESSEX	)	

David Rauch, of full age, being duly sworn according to law, upon his oath deposes and says:

1. I am one of the shareholders of Flexon Industries Corp. and I have personal knowledge of the facts set forth in this affidavit.

2. Flexon Industries Corp. is a New Jersey corporation with a mailing address of 366 Frelinghuysen Avenue, Newark, New Jersey.

3. Thirty-three Queen Realty, Inc. is a New York corporation with a mailing address of 366 Frelinghuysen Avenue, Newark, New Jersey.

4. Flexon Industries Corp. is an inactive entity without presiding officers or board members and has been Inactive for many years.

5. Flexon Industries Corp. is not an operating entity, it has no subsidiaries and it is not a successor to another company.

6. Flexon Industries Corp. has no employees.

7. Flexon Industries Corp. does not have any cash flow or income and has no assets.

8. Flexon Industries Corp. does not prepare financial statements due to its lack of assets.

9. The shareholders of Thirty-three Queen Realty, Inc. are the parents and in-laws of the shareholders of Flexon Industries Corp.

I certify that the foregoing statements made by me are true.

David Rauch

Sworn and subscribed before me on this
30th day of April, 2013

Notary Public

SEEBARRAT POORAN
Notary Public - State of New York
NO. 01PO4934689
Qualified in Kings County
My Commission Expires 6/20/14

2391924

AMENDMENT AND

RIDER TO LEASE AGREEMENT

Landlord:	FOUNDRY STREET CORPORATION
Tenant:	AUTOMATIC ELECTRO-PLATING CORP.
Premises:	rear of 185 Foundry St., Newark, NJ
Term:	Original term was from 3/01/89 thru 2/28/99. By agreement dated 3/01/00 it was extended to 2/28/02.

Amendment:

Effective beginning on 3/01/02 the parties agree that the rent schedule shall be changed to the following:

	Annual	Payable Monthly
3/01/02 - 2/28/03	$ 129,301.81	$ 10,775.15
3/01/03 - 2/28/04	135,766.90	11,313.91
3/01/04 - 2/28/05	142,555.24	11,879.60
3/01/05 - 2/28/06	149,683.01	12,473.50
3/01/06 - 2/28/07	157,167.16	13,097.26
3/01/07 - 2/28/08	165,025.52	13,752.13
3/01/08 - 2/28/09	173,276.79	14,439.73
3/01/09 - 2/28/10	181,940.63	15,141.72
3/01/10 - 2/28/11	191,037.66	15,919.81
3/01/11 - 2/28/12	200,584.54	16,715.80
Total Due	$1,626,344.26	

and the lease term shall be extended to 2/28/12.

All other provisions, including in the agreement dated 3/01/00, shall remain in force as is.

FOUNDRY STREET CORP.

_______________ corp. secretary

by: _______________
Gerald Borriello, President

AUTOMATIC ELECTRO-PLATING CORP.

_______________ corp. secretary

by: _______________
George H. Scott, President

RIDER

AGREEMENT BETWEEN **Foundry Street Corporation** ,a New Jersey corporation with office at 185 Foundry Street, Newark, NJ and **Automatic Electro-Plating Corp.** ,a New Jersey corporation with office at 185 Foundry Street, Newark, New Jersey. **Foundry Street Corp.** is referred to as Landlord. **Automatic Electro-Plating Corp.** is referred to as Tenant.

1. **Extension of the term of the Lease**, for all property located on Landlords premises at 185 Foundry Street, Newark, New Jersey. Included are Buildings #19, #21 and #22. The term of the Lease is extended to February 28, 2002.

2. **The following conditions apply:**

   a. The rent for the period March 1st ,1999 thru February 29,2000 shall be $111,695.64 annually or **$9,307.97** per month.

      From March 1st, 2000 to February 28, 2001 the rent shall be $117,280.42 annually or **$9,773.37** per month.

      From March 1st.,2001 to February 28,2002 the rent shall be $123,144.58 annually or **$10,262.05** per month.

   b. All terms and conditions of the original Lease made and dated March 1st.,1989 apply except to #31st. The Real Estate Taxes shall be paid to the City of Newark by the Landlord. The tenant has no responsibility for any Real Estate Taxes.

   c. The Landlord shall be held harmless for any environmental violations. Any new environmental laws or regulations enacted after the original Lease was signed are the responsibility of the Tenant.

Maria L. Gorfain	Gerald Borriello	George H. Scott
Maria L. Gorfain	Gerald Borriello	George H. Scott
Witness	Secretary FOUNDRY STREET CORP.	President AUTOMATIC ELECTRO-PLATING CORP.

Dated: 3/1/2000

CERTIFICATION OF ROBERT J. SIVERD ON BEHALF OF SETTLING THIRD-PARTY DEFENDANTS GK TECHNOLOGIES, INCORPORATED AND GENERAL CABLE INDUSTRIES, INC.

I, Robert J. Siverd, do hereby certify that:

1. I am the Executive Vice President of GK Technologies, Incorporated, and I am authorized to make this certification.

2. General Cable Corporation, a New Jersey company that was formed in approximately 1927, ("GCC NJ"), owned and operated the wire and power cable research and development facility at 236 West First Street in Bayonne, New Jersey ("Bayonne Facility") from approximately 1929 until approximately 1978, which is referred to in Third-Party Complaint "B" in the Newark Bay Complex litigation.

3. In 1978, GCC NJ sold the Bayonne Facility to Pirelli Cable Corporation ("Pirelli"). GCC NJ ceased operations at the Bayonne Facility upon the sale of the facility to Pirelli.

4. On April 25, 1979, GCC NJ changed its name to GK Technologies, Incorporated ("Old GK Tech NJ").

5. On May 5, 1981, GK Technologies, Incorporated merged into PCC Technologies, Incorporation, a New Jersey company incorporated on November 21, 1980.

6. On March 26, 1982, PCC Technologies, Incorporated changed its name to GK Technologies, Incorporated ("New GK Tech NJ").

7. On June 29, 1992, New GK Tech NJ entered into an agreement with General Cable (Name Holding) Corporation ("General Cable (Name Holding)"), a Delaware company originally incorporated on March 12, 1979 as G.K. Technologies, Incorporated ("GK Tech DE"), to assign the assets, properties and business of New GK Tech NJ's General Cable Division to General Cable (Name Holding). In exchange, General Cable (Name Holding) assumed the liabilities of New GK Tech NJ's General Cable Division.

8. On June 29, 1992, General Cable (Name Holding) changed its name to General Cable Industries, Inc. ("GCII").

9. On February 4, 2009, Defendants Maxus Energy Corporation ("Maxus") and Tierra Solution, Inc. ("Tierra") filed Third-Party Complaint "B," which included a claim against General Cable Industries, Incorporated, a corporation organized under the laws of the State of Delaware. *See* paragraph 95 of Third-Party Complaint "B.") Maxus and Tierra allege in paragraphs 1376 and 1377 of Third-Party Complaint "B" that an entity named General Cable

Corporation owned and operated the Bayonne Facility, and that this entity subsequently changed its name to General Cable Industries, Incorporated.

10. As described in the corporate history recited above, GCC NJ, the owner and operator of the Bayonne Facility, subsequently changed its name to GK Technologies, Incorporated (now New GK Tech NJ) and not to General Cable Industries, Incorporated.

11. New GK Tech NJ is now the corporate parent of GCII.

12. Both New GK Tech NJ and GCII are "Settling Third Party Defendants" as defined in paragraph 18.32 of the Consent Judgment.

ROBERT J. SIVERD

DATE: APRIL 15, 2013

Delaware

The First State

I, JEFFREY W. BULLOCK, SECRETARY OF STATE OF THE STATE OF DELAWARE DO HEREBY CERTIFY THAT THE ATTACHED IS A TRUE AND CORRECT COPY OF THE CERTIFICATE OF CONVERSION OF A DELAWARE LIMITED LIABILITY COMPANY UNDER THE NAME OF "GENTEK HOLDING, LLC" TO A DELAWARE CORPORATION, CHANGING ITS NAME FROM "GENTEK HOLDING, LLC" TO "GENERAL CHEMICAL CORPORATION", FILED IN THIS OFFICE ON THE SIXTH DAY OF OCTOBER, A.D. 2010, AT 8:39 O'CLOCK A.M.

A FILED COPY OF THIS CERTIFICATE HAS BEEN FORWARDED TO THE NEW CASTLE COUNTY RECORDER OF DEEDS.

SECRETARY'S OFFICE 1793 DELAWARE 1855

Jeffrey W. Bullock, Secretary of State

2079717 8100V

AUTHENTICATION: 8271414

100971379

DATE: 10-06-10

State of Delaware
Secretary of State
Division of Corporations
Delivered 08:39 AM 10/06/2010
FILED 08:39 AM 10/06/2010
SRV 100971379 - 2079717 FILE

CERTIFICATE OF CONVERSION TO CORPORATION
OF
GENTEK HOLDING, LLC
TO
GENERAL CHEMICAL CORPORATION

Pursuant to Section 265 of the Delaware General Corporation Law (the "DGCL") and Section 18-216 of the Delaware Limited Liability Company Act

This Certificate of Conversion to Corporation (the "Certificate"), dated as of October 6, 2010, is being duly executed and filed by GenTek Holding, LLC, a Delaware limited liability company (the "LLC"), to convert the LLC to General Chemical Corporation, a Delaware corporation (the "Corporation"), under the DGCL (8 Del. C. § 101, et seq.) and the Delaware Limited Liability Company Act (6 Del. C. § 18-101, et seq.).

FIRST: The LLC filed its original Certificate of Formation with the Secretary of State of the State of Delaware and was first formed on December 27, 1985 in the State of Delaware.

SECOND The LLC's name immediately prior to the filing of this Certificate was GenTek Holding, LLC.

THIRD The name of the Corporation into which the LLC shall be converted, as set forth in its Certificate of Incorporation, is General Chemical Corporation.

FOURTH: The conversion of the LLC to the Corporation has been approved in accordance with the provisions of Section 265 of the DGCL and Section 18-216 of the Delaware Limited Liability Company Act.

FIFTH The conversion of the LLC to the Corporation shall be effective on the filing of this Certificate and the Certificate of Incorporation with the Secretary of State of the State of Delaware.

[SIGNATURE PAGE TO FOLLOW]

IN WITNESS WHEREOF, the undersigned has executed this Certificate of Conversion to Corporation as of the date first written above.

GENTEK HOLDING, LLC
by General Chemical Holding Company, its sole member

By: ____________________
Name: Eric Schondorf
Title: VP, Secretary and Assistant Treasurer

CERTIFICATION

I, Joshua Dicker, Senior Vice President and General Counsel of Getty Properties Corp., submit this Certification in the matter of *New Jersey Department of Environmental Protection, et. al., v. TRMI-H LLC, etc. et al.*, N.J. Super. Ct. No. L-9868-05 (Essex County) and state as follows:

1. This Certification is submitted to confirm the relationship between third-party defendants Getty Properties Corp. and Power Test Realty Company Limited Partnership and said entities' affiliation with the property located at 86 Doremus Avenue, Newark, New Jersey and identified in the Third Party Complaint "C" as the "Newark Terminal."

2. As to the relationship of the third-party defendants, Getty Properties Corp. is a Delaware Corporation and the General Partner of Power Test Realty Company Limited Partnership, a New York limited partnership formed in January 1985.

3. Power Test Realty Company Limited Partnership became the owner of the Newark Terminal on or about February 1, 1985, pursuant to an Asset Purchase Agreement dated December 21, 1984 by and between Texaco, Inc., and Texaco's then affiliated entities Getty Oil Company and Getty Refining and Marketing Company on the one hand and Power Test Corp. on the other hand. Power Test Realty Company Limited Partnership has been the owner of the Newark Terminal, since its acquisition in 1985 to the date hereof.

4. Subsequent to the 1985 Asset Purchase Agreement, Power Test Corp. changed its name to Getty Petroleum Corp.

5. Power Test Realty Company Limited Partnership leased the Newark Terminal pursuant to a lease agreement dated February 1, 1985 ("Newark Property Lease") to Clay Oil Terminals, Inc., which until 1997 was a wholly owned subsidiary of Getty Petroleum Corp.
6. Pursuant to a Reorganization and Distribution Agreement dated January 31, 1997, Getty Petroleum Corp. spun off its petroleum distribution and marketing business, including its subsidiary Getty Terminals Corp (f/k/a Clay Oil Terminals, Inc.) to a separate NYSE-listed entity named Getty Petroleum Marketing, Inc., which became the owner, operator and successor of the petroleum distribution and marketing business.
7. In connection with the spin-off, Getty Petroleum Corp. changed its name to Getty Realty Corp. (DE).
8. Thereafter, on or about February 1, 1997, the Newark Terminal Lease was assigned to Getty Realty Corp. who subleased the Newark Terminal to Getty Petroleum Marketing, Inc., (the successor-in-interest to Getty Terminals Corp. (f/k/a Clay Oil Terminals).
9. Getty Realty Corp. (DE) subsequently changed its name to its current name Getty Properties Corp. (DE).
10. The allegations asserted against third-party defendants Getty Properties Corp. and Power Test Realty Company Limited Partnership in Complaint C all relate to the same site, the Newark Terminal, with respect to the same alleged discharges, which are denied, and were all allegedly occurring during the same time period.

To the extent the information and statements set forth above relate to time periods prior to February 2008, the date I first became affiliated with Getty Properties Corp. and Power Test Realty Company Limited Partnership, the information and statements are derived from a review of historical documents and information provided by persons formerly associated with the operations of the Newark Terminal and not my personal knowledge. I am aware that if the foregoing statements made by me are willfully false, I may be subject to punishment.

By: ______________________
Joshua Dicker, Esquire,
Senior V.P. and General Counsel of
Getty Properties Corp.

Dated: 4-25-13

JON S. CORZINE
Governor

LISA P. JACKSON
Commissioner

IN THE MATTER OF
THE NEWARK SITE : REMEDIATION
THE ESTATE OF HENRY BORDA : AGREEMENT
AND INDUSTRIAL PETROCHEMICALS, INC.

ISRA Case #'S E86317 AND E20080217
PI # 002132

This Remediation Agreement is issued and entered into pursuant to the authority vested in the Commissioner of the New Jersey Department of Environmental Protection, (hereinafter the "Department" or "DEP") by N.J.S.A. 13:1D-1 et seq., the Industrial Site Recovery Act ("ISRA") N.J.S.A. 13:1K-6 et seq., and the Spill Compensation and Control Act, N.J.S.A. 58:10-23.11 et seq., and duly delegated to the Assistant Director for the Enforcement and Assignment Element within the Site Remediation Program pursuant to N.J.S.A. 13:1B-4.

FINDINGS

1. The property that is the subject of this Remediation Agreement is located at 128 – 146 Doremus Avenue, and designated as Block 5011, Lot 10 on the tax maps of the City of Newark, Essex County, New Jersey (hereinafter "Property"), and includes all other areas to which any hazardous substance discharged on the Property has migrated (collectively, "the Site" or "Newark Site"). The Property is owned by the Estate of Henry J. Borda and is operated by GJ Chemical Company, Inc.

2. Industrial Petrochemicals, Inc. ("Old IPC"), a New Jersey corporation, began operating at the Property in or about 1955, and Henry J. Borda owned all of the outstanding shares of Old IPC by 1957. Henry J. Borda purchased the Property in 1976. By Agreement dated June 27, 1983, Henry J. Borda sold all the issued and outstanding stock of Old IPC to Vitusa Corp., which continued to operate Old IPC at the Property. The Agreement also provided an option to Vitusa Corp. to purchase the Property.

3. On April 27, 1986, Masci Doremus Enterprises, Inc. entered into a Franchise Agreement with Old IPC. The Franchise Agreement provided that Old IPC would change its name to Vitusa International Inc. (now known as Doremus Holdings Corp.) and would form a new subsidiary, Industrial Petrochemicals, Inc. ("New IPC"). In exchange for payment of a Franchise Fee, Masci Doremus Enterprises, Inc. would receive stock in New IPC. The Franchise Fee was paid and 21% of the issued and outstanding stock of New IPC was transferred to Masci Doremus Enterprises, Inc. Shortly thereafter, GJ Chemical Company, Inc., an affiliate of Masci Doremus

Enterprises, Inc., began operating at the Property. Old IPC ceased operations at the Property.

4. The Franchise Agreement referenced in paragraph 3 above also provided Masci Doremus Enterprises, Inc. with the right to cause Vitusa Corp. to exercise its option to purchase the Property and thereafter transfer the title to same to New IPC.

5. Responsibility for ISRA compliance as a result of the above-referenced transactions has been disputed and has been the subject of two lawsuits. The first litigation was dismissed without prejudice; settlement of the second litigation has been reached among the plaintiffs Masci Doremus Enterprises, Inc., GJ Chemical Company, Inc. and certain affiliated entities (the "GJ Parties") and the defendants, including among other parties the Estate of Henry J. Borda and Vitusa Corp. Among other things, the settlement provides that the Estate of Henry J. Borda will transfer title to the real property to the GJ Parties, or their designee and Vitusa Corp. will transfer the remaining shares of stock of New IPC to Masci Doremus Enterprises, Inc. In exchange the GJ Parties agreed to accept responsibility for ISRA compliance at the Site. The parties' intent in entering into the settlement is to resolve responsibility for ISRA compliance at the Site.

6. On March 17, 2008, Dynasty Enterprise Group, LLC submitted to the Department an application for a Remediation Agreement pursuant to N.J.A.C. 7:26B-4.1. This Remediation Agreement application is incorporated herein by reference and includes the following information:

A. Transaction

Transferors:	The Estate of Henry J. Borda Vitusa Corp.
Transferees:	Dynasty Enterprise Group, LLC Masci Doremus Enterprises, Inc.

Description: The Estate of Henry J. Borda will transfer title to the Property to Dynasty Enterprise Group, LLC. In addition, Vitusa Corp. will transfer to Masci Doremus Enterprises, Inc. the remaining shares of stock in New IPC that Masci Doremus Enterprises, Inc. does not already own. This Remediation Agreement will also encompass IPC's cessation of operations at the Property in or about 1986. GJ Chemical Company, Inc. will continue operations at the Property as a subtenant (or similar arrangement) with Doremus Terminal Operations, LLC, which will become the tenant and operator at the Property.

B. Person(s) executing this Remediation Agreement and responsible for conducting the remediation of the Site (hereinafter referred to as "Person(s)").

Name:	Dynasty Enterprise Group, LLC
Business Association:	a New Jersey limited liability company
Address:	128-146 Doremus Avenue Newark, NJ 07114
Telephone No.:	(973) 589-1450

7. The Department and Dynasty Enterprise Group, LLC expressly agree that the terms and conditions of this Remediation Agreement apply to the Site listed in paragraph 1 above. Furthermore, the Department and Dynasty Enterprise Group, LLC agree to administer and complete all applicable ISRA program requirements, including the remediation funding source requirements and any other remedial measures undertaken pursuant to this Remediation Agreement and ISRA, for the Site.

8. The transactions described in paragraph 6.A above are the transfer of ownership or operations of an industrial establishment as defined by ISRA. The Department and Dynasty Enterprise Group, LLC expressly agree that the transactions described in paragraph 6.A above are subject to ISRA. Dynasty Enterprise Group, LLC has requested that the Department prepare a Remediation Agreement which, when effective, will allow the transactions described in paragraph 6.A above to be consummated prior to the completion of all administrative and remediation requirements pursuant to ISRA.

9. By entering into this Remediation Agreement, Dynasty Enterprise Group, LLC neither admits to any fact, fault or liability under any statute or regulation concerning the condition of the Site nor waives any rights or defenses with regard to the Site except as specifically provided in this Remediation Agreement.

10. The scope of the remediation required by this Remediation Agreement includes all contaminants within the meaning of the Industrial Site Recovery Act, N.J.S.A. 13:1K-6 et seq., and the Spill Compensation and Control Act, N.J.S.A. 58:10-23.11 et seq. (hereinafter "contaminants") at the above referenced Site, and all contaminants which are emanating from or which have emanated from the Site.

AGREEMENT

I. Remedial Investigation Requirements

1. Within ninety (90) calendar days after the effective date of this Remediation Agreement, as set forth in paragraph 66 below (hereinafter "the effective date of this Remediation Agreement"), or as otherwise approved in writing by the Department, Dynasty Enterprise Group, LLC agrees to submit to the Department a detailed Remedial Investigation Work Plan (hereinafter the "RI Work Plan") in accordance with N.J.A.C.

7:26E, including a schedule pursuant to N.J.A.C. 7:26E-4.2(b) to complete the delineation of soils and groundwater. Dynasty Enterprise Group, LLC agrees to include in the RI Work Plan a baseline ecological evaluation pursuant to N.J.A.C. 7:26E-3.11 and **all other work required by N.J.A.C. 7:26E-3.1 et seq.**, that the Department has not already approved for the Site.

2. Within thirty (30) calendar days after receipt of the Department's written comments on the RI Work Plan, or as otherwise approved in writing by the Department, Dynasty Enterprise Group, LLC agrees to modify the RI Work Plan to conform to the Department's comments and agrees to submit the modified RI Work Plan to the Department. The determination as to whether or not the modified RI Work Plan, as resubmitted, conforms to the Technical Requirements for Site Remediation, N.J.A.C. 7:26E, and the Department's written comments and is otherwise acceptable to the Department shall be made solely by the Department in writing. When the Department determines that the RI Work Plan conforms to the Technical Requirements for Site Remediation and the Department's comments, it shall send Dynasty Enterprise Group, LLC written final approval of the RI Work Plan.

3. Upon receipt of the Department's written final approval of the RI Work Plan, Dynasty Enterprise Group, LLC agrees to conduct the remedial investigation in accordance with the approved RI Work Plan and the schedule therein.

4. Dynasty Enterprise Group, LLC agrees to submit to the Department a Remedial Investigation Report (hereinafter "RI Report") in accordance with N.J.A.C. 7:26E and the RI Work Plan and the schedule therein.

5. If upon review of the RI Report the Department determines that additional remedial investigation is required, the Department shall notify Dynasty Enterprise Group, LLC of the additional work that is required. Dynasty Enterprise Group, LLC agrees to submit to the Department another RI Workplan and schedule for the additional work. Upon approval of the RI Workplan for the additional required work, Dynasty Enterprise Group, LLC agrees to conduct additional remedial investigation and submit another RI Report pursuant to the approved schedule.

6. Within thirty (30) calendar days after receipt of the Department's written comments on the RI Report, or longer as authorized by the Department, Dynasty Enterprise Group, LLC agrees to modify the RI Report to conform to the Department's comments and agrees to submit the modified RI Report to the Department. The determination as to whether or not the modified RI Report, as resubmitted, conforms to the Technical Requirements for Site Remediation, N.J.A.C. 7:26E, and the Department's written comments and is otherwise acceptable to the Department shall be made solely by the Department in writing. When the Department determines that the RI Report conforms to the Technical Requirements for Site Remediation and the Department's comments, it shall send Dynasty Enterprise Group, LLC written final approval of the RI Report.

II. Remedial Action Requirements

7. Within ninety (90) calendar days after receipt of the Department's written approval of the RI Report, Dynasty Enterprise Group, LLC agrees to submit to the Department a Remedial Action Work Plan in accordance with N.J.A.C. 7:26E.

8. Within thirty (30) calendar days after receipt of the Department's written comments on the Remedial Action Work Plan, or as otherwise approved in writing by the Department, Dynasty Enterprise Group, LLC agrees to modify the Remedial Action Work Plan to conform to the Department's comments and agrees to submit the modified Remedial Action Work Plan to the Department. The determination as to whether or not the modified Remedial Action Work Plan, as resubmitted, conforms to the Technical Requirements for Site Remediation, N.J.A.C. 7:26E, and the Department's written comments and is otherwise acceptable to the Department shall be made solely by the Department in writing. When the Department determines that the RA Work Plan conforms to the Technical Requirements for Site Remediation and the Department's comments, it shall send Dynasty Enterprise Group, LLC written final approval of the RA Work Plan.

9. Upon receipt of the Department's written final approval of the Remedial Action Work Plan, Dynasty Enterprise Group, LLC agrees to implement the approved Remedial Action Work Plan in accordance with the schedule therein.

10. Dynasty Enterprise Group, LLC agrees to submit to the Department a Remedial Action Report (hereinafter "RA Report") in accordance with the Technical Requirements for Site Remediation, N.J.A.C. 7:26E, the RA Work Plan and the schedule therein.

11. If upon review of the RA Report the Department determines that additional remediation is required, Dynasty Enterprise Group, LLC agrees to conduct additional remediation as required by the Department including submission of additional workplans and reports, as applicable.

12. Within thirty (30) calendar days after receipt of the Department's written comments on the RA Report, or longer as authorized by the Department, Dynasty Enterprise Group, LLC agrees to modify the RA Report to conform the Department's comments, and agrees to submit the modified RA Report to the Department. The determination as to whether or not the modified RA Report, as resubmitted, conforms to the Technical Requirements for Site Remediation, N.J.A.C. 7:26E and the Department's written comments, and is otherwise acceptable to the Department shall be made solely by the Department in writing. When the Department determines that the RA Report conforms to the Technical Requirements for Site Remediation and the Department's comments, it shall send Dynasty Enterprise Group, LLC written final approval of the RA Report.

III. Additional Remedial Investigation and Remedial Action

13. If at any time that this Remediation Agreement is in effect the Department determines that the prevailing standards in N.J.A.C. 7:26E are not being achieved or that additional remediation is required to protect the public health and safety or the environment, Dynasty Enterprise Group, LLC agrees to conduct such additional remediation as the Department directs.

14. If the Department determines that no further action is required at the Site, Dynasty Enterprise Group, LLC shall submit a negative declaration, in accordance with N.J.A.C. 7:26B-6. 7, within thirty (30) calendar days or longer as authorized by the Department from receipt of the Department's request for the submission of the negative declaration.

IV. Progress Reports

15. Dynasty Enterprise Group, LLC agrees to submit quarterly progress reports which detail the status of Dynasty Enterprise Group, LLC's compliance with this Remediation Agreement to the Department in accordance with N.J.A.C. 7:26E-6.6. Dynasty Enterprise Group, LLC agrees to submit the first progress report on or before the last calendar day of the fourth calendar month following the effective date of this Remediation Agreement. Dynasty Enterprise Group, LLC agrees to submit a progress report thereafter on or before the last calendar day of the month following the next three calendar months being reported. Dynasty Enterprise Group, LLC may request that the Department allow progress reports to be submitted semi-annually or annually.

V. Project Coordination

16. Dynasty Enterprise Group, LLC agrees to submit to the Department all documents required by this Remediation Agreement, including correspondence relating to force majeure issues pursuant to section IX of this Agreement by delivery with an acknowledgment of receipt from the Department. The date that the Department executes the acknowledgment will be the date the Department uses to determine Dynasty Enterprise Group, LLC's compliance with the requirements of this Remediation Agreement for purposes of assessing penalties and availing itself of any other applicable remedies.

17. Within seven (7) calendar days after the effective date of this Remediation Agreement, Dynasty Enterprise Group, LLC agrees to submit to the Department the name, title, address and telephone number of the individual who shall be Dynasty Enterprise Group, LLC's technical contact for the Department for all matters concerning this Remediation Agreement. In the event the Department determines that a meeting concerning the remediation of the Site is necessary, the Department will provide notification to Dynasty Enterprise Group, LLC's agent, identified in paragraph 46 below of the date, time and place of such meeting. Dynasty Enterprise Group, LLC agrees to ensure that the agent is available for and participates in such meeting.

18. Within seven (7) days after the effective date of this Remediation Agreement the Department will identify the individual who will be the Department's contact for all matters concerning this Remediation Agreement. Unless the Department otherwise directs in writing, Dynasty Enterprise Group, LLC agrees to submit all payments and copies of all documents required by this Remediation Agreement to the Department's contact.

19. Dynasty Enterprise Group, LLC agrees to notify, both verbally and in writing, the Department's contact person identified pursuant to paragraph 18, above, at least fourteen (14) calendar days prior to the initiation of any field activities at the Site which are related to remediation, development or redevelopment.

20. The Department will consider a written request for an extension of time to perform any requirement under this Remediation Agreement, provided that Dynasty Enterprise Group, LLC submits any extension request to the Department two weeks prior to any applicable deadline to which the extension request refers.

VI. Remediation Funding Source

21. Dynasty Enterprise Group, LLC agrees to establish and maintain during the life of this Remediation Agreement a remediation funding source in an amount equal to the Department approved estimate of the remediation costs related to compliance with this Remediation Agreement, including all operation, maintenance and monitoring costs of all engineering and institutional controls, pursuant to N.J.A.C. 7:26E-8, used to remediate the Site, pursuant to N.J.A.C. 7:26C-7. Dynasty Enterprise Group, LLC agrees that the initial amount is **$350,000.00**.

22. Dynasty Enterprise Group, LLC agrees to pay an **annual remediation funding source surcharge** if required to do so pursuant to N.J.A.C. 7:26C-7.8.

23. Beginning three hundred sixty-five (365) calendar days after the effective date of this Remediation Agreement, and annually thereafter on the same calendar day, Dynasty Enterprise Group, LLC agrees to submit to the Department a detailed review of all remediation costs expended by Dynasty Enterprise Group, LLC to comply with this Remediation Agreement, including:

(a) A detailed summary of all monies spent to date pursuant to this Remediation Agreement;

(b) The detailed estimated remediation costs required to comply with this Remediation Agreement, including all operation, maintenance and monitoring costs; and

(c) The reason for any changes from the previously submitted cost review.

24. At any time after Dynasty Enterprise Group, LLC submits the first cost review pursuant to the preceding paragraph, Dynasty Enterprise Group, LLC may request the Department's approval to reduce the amount of the remediation funding source to reflect the remaining remediation costs necessary to comply with obligations under this Remediation Agreement. If the Department grants written approval to such a request, Dynasty Enterprise Group, LLC may amend the amount of the then existing remediation funding source consistent with that approval.

25. If the estimated costs of meeting Dynasty Enterprise Group, LLC's obligations in this Remediation Agreement at any time increase to an amount greater than the remediation funding source, Dynasty Enterprise Group, LLC agrees to, within thirty (30) calendar days after receipt of written notice of the Department's determination, increase the amount of the then existing remediation funding source or provide an additional remediation funding source such that the total amount equals the Department's approved estimated cost.

26. If Dynasty Enterprise Group, LLC remediates the Site to a restricted use remediation standard and Dynasty Enterprise Group, LLC implements institutional and engineering controls, Dynasty Enterprise Group, LLC shall maintain the remediation funding source, pursuant to N.J.A.C. 7:26C-7, in an amount necessary to pay for the maintenance of the engineering and institutional controls.

VII. Oversight Cost Reimbursement

27. All submissions required pursuant to this Remediation Agreement shall be accompanied by all appropriate fees pursuant to N.J.A.C. 7:26B-8.

28. Within thirty (30) calendar days after receipt from the Department of a written summary of the Department's oversight costs, including all accrued interest incurred pursuant to paragraph 30 below, determined pursuant to N.J.A.C. 7:26B-8, Dynasty Enterprise Group, LLC agrees to submit to the Department a cashier's or certified check payable to the "Treasurer, State of New Jersey" and submitted with DEP Form 062A, for the full amount of the Department's oversight costs, for the period invoiced in the Department's summary.

29. Dynasty Enterprise Group, LLC agrees that its agreement here to pay the Department's oversight costs will continue after the Department's termination of this Remediation Agreement as provided herein for those oversight costs that have accrued prior to that termination.

30. Dynasty Enterprise Group, LLC also agrees to pay interest on the unpaid balance of oversight costs, beginning at the end of the thirty (30) calendar day period established in paragraph 28, above, at the rate established by Rule 4:42 of the current edition of the Rules Governing the Courts of the State of New Jersey.

VIII. Reservation of Rights

31. The Department reserves the right to unilaterally terminate this Remediation Agreement in the event that the Department determines that Dynasty Enterprise Group, LLC has violated the terms of this Remediation Agreement. Before the Department unilaterally terminates this Remediation Agreement, the Department shall notify Dynasty Enterprise Group, LLC in writing of the obligation(s) which it has not performed, and Dynasty Enterprise Group, LLC shall have thirty (30) calendar days after receipt of such notice to perform such obligation(s).

32. Nothing in this Remediation Agreement precludes the Department from seeking civil or civil administrative penalties or any other legal or equitable relief against Dynasty Enterprise Group, LLC for violations of this Remediation Agreement. In any such action brought by the Department under this Remediation Agreement for injunctive relief, civil, or civil administrative penalties, Dynasty Enterprise Group, LLC may raise, among other defenses, a defense that Dynasty Enterprise Group, LLC failed to comply with a decision of the Department, made pursuant to this Remediation Agreement, on the basis that the Department's decision was arbitrary, capricious or unreasonable. If Dynasty Enterprise Group, LLC is successful in establishing such a defense based on the administrative record, Dynasty Enterprise Group, LLC shall not be liable for penalties for failure to comply with that particular requirement of the Remediation Agreement. Although Dynasty Enterprise Group, LLC may raise such defenses in any action initiated by the Department for injunctive relief, Dynasty Enterprise Group, LLC hereby agrees not to otherwise seek review of any decision made or to be made by the Department pursuant to this Remediation Agreement, except as provide in paragraph 45 of this Agreement. Under no circumstances shall Dynasty Enterprise Group, LLC initiate any action or proceeding challenging any decision made or to be made by the Department pursuant to this Remediation Agreement.

33. This Remediation Agreement shall not be constructed to affect or waive the claims of Federal or State natural resources trustees against any person for damages or injury to, destruction of, or loss of natural resources, unless expressly provided herein, and then only to the extent expressly provided herein.

34. Except as otherwise stated in this Remediation Agreement, nothing herein shall be construed as limiting any legal, equitable or administrative remedies which Dynasty Enterprise Group, LLC may have under any applicable law or regulation. In any enforcement action the Department initiates pursuant to this Remediation Agreement, Dynasty Enterprise Group, LLC reserves any defenses which the Spill Compensation and Control Act, *Matter of Kimber Petroleum Corp.*, 110 N.J. 69 (1988) or their amendments, supplements and progeny allow.

35. Except as otherwise set forth herein, by the execution of this Remediation Agreement, it does not release Dynasty Enterprise Group, LLC, from any liabilities or

obligations Dynasty Enterprise Group, LLC may have pursuant to any other authority, nor does the Department waive any of its rights or remedies pursuant thereto.

36. Nothing in this Remediation Agreement shall be construed to limit, restrict or prohibit any person(s) responsible for conducting the remediation of the Site from implementing any applicable ISRA compliance options in accordance with N.J.A.C. 7:26B-5 to satisfy the requirements of ISRA.

37. Notwithstanding any other provision of this Remediation Agreement, the Department is not barred from, the Department reserves, and this Remediation Agreement is without prejudice to, the right to institute proceedings or to issue administrative orders seeking injunctive relief, penalties, damages or any other remedies authorized by law for past, present or future violations of any statute, regulation or order.

38. This Remediation Agreement does not pertain to matters other than the future remediation of the contaminated Site by Dynasty Enterprise Group, LLC. The Department reserves, and this Remediation Agreement is without prejudice to, all rights against Dynasty Enterprise Group, LLC and anyone else concerning all other matters, including the following:

(a) Liability arising from the past, present or future discharge or unsatisfactory storage or containment of any hazardous substance outside the contaminated Site;

(b) Liability for any future discharge or unsatisfactory storage or containment of any hazardous substance at the contaminated Site, other than as provided for in this Remediation Agreement or as otherwise ordered by the Department;

(c) Criminal liability;

(d) Liability for any violation of any law that occurred prior to or occurs after the effective date of this Remediation Agreement;

(e) Liability for any claim against the New Jersey Spill Compensation Fund; and

(f) Penalties for past acts or failure to act.

IX. Force Majeure

39. If any event specified in the following paragraph occurs which Dynasty Enterprise Group, LLC believes or should believe will or may cause delay in the compliance or cause non-compliance with any provision of this Remediation Agreement, Dynasty Enterprise Group, LLC shall notify the Department in writing within seven (7) calendar days of the start of delay or knowledge of the anticipated delay, as appropriate, referencing this paragraph and describing the anticipated length of the delay, the precise

cause or causes of the delay, any measures taken or to be taken to minimize the delay, and the time required to take any such measures to minimize the delay. Dynasty Enterprise Group, LLC shall take all necessary action to prevent or minimize any such delay.

40. The Department will extend in writing the time for compliance for a period no longer than the delay resulting from such circumstances as determined by the Department only if:

(a) Dynasty Enterprise Group, LLC has complied with the notice requirements of the preceding paragraph;

(b) Any delay or anticipated delay has been or will be caused by fire, flood, riot, strike or other circumstances beyond the control of Dynasty Enterprise Group, LLC; and

(c) Dynasty Enterprise Group, LLC has taken all necessary action to prevent or minimize any such delay.

41. The burden of proving that any delay is caused by circumstances beyond the control of Dynasty Enterprise Group, LLC and the length of any such delay attributable to those circumstances shall rest with Dynasty Enterprise Group, LLC.

42. "Force Majeure" shall not include the following:

(a) Delay in an interim requirement with respect to the attainment of subsequent requirements;

(b) Increases in the cost or expenses incurred by Dynasty Enterprise Group, LLC in fulfilling the requirements of this Remediation Agreement;

(c) Contractor's breach, unless Dynasty Enterprise Group, LLC demonstrates that such breach falls within paragraph 40 above; and

(d) Failure to obtain access required to implement this Remediation Agreement, unless denied by a court of competent jurisdiction.

X. Penalties

43. Dynasty Enterprise Group, LLC agrees to pay penalties for its violations of this Remediation Agreement, or for its failure to implement and maintain institutional controls including, by way of example, a deed notice or declaration of environmental restriction that are part of a remedial action implemented pursuant to this Remediation Agreement order, according to the amounts and conditions in N.J.A.C. 7:26C-10.

44. Dynasty Enterprise Group, LLC agrees that its payments of a penalty pursuant to this Remediation Agreement does not alter Dynasty Enterprise Group, LLC's responsibility to complete any requirement of this Remediation Agreement.

XI. Dispute Resolution

45. In the event a conflict arises between Dynasty Enterprise Group, LLC and the Department, Dynasty Enterprise Group, LLC may initiate the Department's dispute resolution process at N.J.A.C. 7:26C-1.4.

XII. General Provisions

46. Dynasty Enterprise Group, LLC agrees that the person listed below is Dynasty Enterprise Group, LLC's agent for the purpose of service for all matters concerning this Remediation Agreement unless and until Dynasty Enterprise Group, LLC provides the Department with the name, title, address, and telephone number of Dynasty Enterprise Group, LLC's new agent.

Name:	Dennis J. Krumholz, Esq.
Company:	Riker Danzig
Address:	One Speedwell Avenue Headquarters Plaza Morristown, NJ 07962
Telephone No.:	(973) 451-8454

47. In addition to the Department's statutory and regulatory rights to enter and inspect, Dynasty Enterprise Group, LLC agrees to allow the Department and its authorized representatives access to all areas of the Site to which Dynasty Enterprise Group, LLC has access, at all times, for the purpose of monitoring Dynasty Enterprise Group, LLC's compliance with this Remediation Agreement and/or to perform any remedial activities Dynasty Enterprise Group, LLC fails to perform as required by this Remediation Agreement. Dynasty Enterprise Group, LLC agrees that the Department's right of access pursuant to this paragraph shall continue after the Department's termination of this Remediation Agreement pursuant to paragraph 31, above.

48. Dynasty Enterprise Group, LLC agrees to not construe any informal advice, guidance, suggestions, or comments by the Department, or by persons acting on behalf of the Department, as relieving Dynasty Enterprise Group, LLC of its obligation to obtain written approvals as required herein.

49. Dynasty Enterprise Group, LLC agrees to provide a copy of this Remediation Agreement to each contractor and subcontractor retained to perform the work required by this Remediation Agreement and agrees to condition all contracts and subcontracts

entered for the performance of such work upon compliance with the terms and conditions of this Remediation Agreement. Dynasty Enterprise Group, LLC agrees to be responsible to the Department for ensuring that its contractors and subcontractors perform the work herein in accordance with this Remediation Agreement.

50. Nothing in this Remediation Agreement relieves Dynasty Enterprise Group, LLC from complying with all other applicable laws and regulations. Compliance with the terms of this Remediation Agreement shall not excuse Dynasty Enterprise Group, LLC from obtaining and complying with any applicable federal, state or local permits, statutes, regulations and/or orders while carrying out the obligations imposed by this Remediation Agreement. This Remediation Agreement shall not preclude the Department from requiring that Dynasty Enterprise Group, LLC obtain and comply with any permits, and/or orders issued by the Department under the authority of the Water Pollution Control Act, N.J.S.A. 58:10A-1 et seq., the Solid Waste Management Act, N.J.S.A. 13:1E-1 et seq., and the Spill Compensation and Control Act, N.J.S.A. 58:10-23.11 et seq., for the matters covered herein. The terms and conditions of any such permit shall not be preempted by the terms and conditions of this Remediation Agreement if the terms and conditions of any such permit are more stringent than the terms and conditions of this Remediation Agreement. Should any of the measures to be taken by Dynasty Enterprise Group, LLC during the remediation of any ground water and surface water pollution result in a new or modified discharge as defined in the New Jersey Pollutant Discharge Elimination System (NJPDES) regulations, N.J.A.C. 7:14A-1 et seq., then Dynasty Enterprise Group, LLC agrees to obtain a NJPDES permit or permit modification from the Department prior to commencement of the activity.

51. All work plans, schedules, and other documents required by this Remediation Agreement and approved in writing by the Department are incorporated herein and made a part hereof.

52. Upon the receipt of a written request from the Department, Dynasty Enterprise Group, LLC agrees to submit to the Department all data and information, including technical records and contractual documents, concerning contamination at the Site, including raw sampling and monitoring data, whether or not such data and information, including technical records and contractual documents, were developed pursuant to this Remediation Agreement. Dynasty Enterprise Group, LLC reserves its right to assert a privilege regarding such documents, but agrees not to assert any confidentiality or privilege claim with respect to any data related to Site conditions, sampling or monitoring.

53. No modification or waiver of this Remediation Agreement shall be valid except by written amendment to this Remediation Agreement duly executed by Dynasty Enterprise Group, LLC and the Department. Any amendment to this Remediation Agreement shall be executed by the Department and Dynasty Enterprise Group, LLC. The Department reserves the right to require the resolution of any outstanding violations of the applicable regulations or this Remediation Agreement prior to executing any such amendment.

54. Dynasty Enterprise Group, LLC waives its rights to an administrative hearing concerning the entry of this Remediation Agreement.

55. This Remediation Agreement shall be governed and interpreted under the laws of the State of New Jersey.

56. If any provision of this Remediation Agreement or the application thereof to any person or circumstance shall, to any extent, be invalid or unenforceable, the remainder of this Remediation Agreement or the application of such provision to persons or circumstances other than those as to which it is held invalid or unenforceable, shall not be affected thereby and each provision of this Remediation Agreement shall be valid and enforced to the fullest extent permitted by law.

57. This Remediation Agreement represents the entire integrated agreement between the Department and Dynasty Enterprise Group, LLC concerning the Site subject to this Remediation Agreement and supersedes all prior negotiations, representations or agreements, either written or oral, unless otherwise specifically provided herein.

58. Within thirty (30) calendar days after the effective date of this Remediation Agreement, Dynasty Enterprise Group, LLC agrees to record a copy of this Remediation Agreement with the County Clerk, [COUNTY] County, State of New Jersey and agrees to provide the Department with written verification of compliance with this paragraph which shall include a copy of this Remediation Agreement stamped "Filed" by the County Clerk.

59. This Remediation Agreement shall be binding, jointly and severally, on each party, its successors, assignees and any trustee in bankruptcy or receiver appointed pursuant to a proceeding in law or equity. No change in the ownership or corporate status of any party or of the industrial establishment or Site shall alter party's responsibilities under this Remediation Agreement.

60. Dynasty Enterprise Group, LLC's document retention policy notwithstanding, Dynasty Enterprise Group, LLC agrees to preserve, during the pendency of this Remediation Agreement and for a minimum of ten (10) years after its termination, all data and information, including technical records, potential evidentiary documentation and contractual documents, in its possession or in the possession of Dynasty Enterprise Group, LLC's divisions, employees, agents, accountants, contractors, or attorneys that relate in any way to the contamination at the Site. After this ten year period, Dynasty Enterprise Group, LLC may make a written request to the Department to discard any such documents. Such a request shall be accompanied by a description of the documents involved, including the name of each document, date, name, and title of the sender and receiver and a statement of contents. Upon receipt of written approval by the Department, Dynasty Enterprise Group, LLC may discard only those documents that the Department does not require to be preserved for a longer period. Upon receipt of a written request by the Department, Dynasty Enterprise Group, LLC agrees to submit to

the Department all data and information, including technical records and contractual documents or copies of the same. Dynasty Enterprise Group, LLC reserves whatever rights it may have, if any, to assert any privilege regarding such data or information, however, Dynasty Enterprise Group, LLC agrees not to assert any privilege or confidentiality claims with respect to data related to Site conditions, sampling, or monitoring.

61. Dynasty Enterprise Group, LLC agrees to provide to the Department written notice of the dissolution of its corporate or partnership identity, the liquidation of the majority of its assets or the closure, termination or transfer of operations in accordance with the schedule set forth at N.J.A.C. 7:26B-3.2 prior to such action. Upon such notice, Dynasty Enterprise Group, LLC agrees to submit a cost review pursuant to this Remediation Agreement to the Department. Dynasty Enterprise Group, LLC agrees to also provide written notice to the Department of a filing of a petition for bankruptcy no later than the first business day after such filing. These requirements shall be in addition to any other statutory requirements arising from the dissolution of corporate or partnership identity, the liquidation of the majority of assets, or the closure, termination or transfer of operations. Upon receipt of notice of dissolution of corporate identity, liquidation of assets or filing of a petition for bankruptcy, the Department may request and, within fourteen (14) days of the Department's written request, the Dynasty Enterprise Group, LLC agrees to obtain and submit to the Department additional financial assurance pursuant to this Remediation Agreement.

62. If Dynasty Enterprise Group, LLC remediates the Site to a restricted use standard as defined in N.J.A.C. 7:26E-1.8 and Dynasty Enterprise Group, LLC implements institutional and engineering controls, this Remediation Agreement shall remain in full force and effect including the requirements to maintain a remediation funding source, and to pay an annual 1% surcharge of the total amount of the remediation funding source until the Department determines that the Site is remediated to the applicable unrestricted use standard.

63. If Dynasty Enterprise Group, LLC remediates contaminated soil at the Site to the Department's unrestricted use soil standard as defined at N.J.A.C. 7:26E-1.8, and any other contaminated media to the applicable remediation standard, the requirements of this Remediation Agreement shall be deemed satisfied upon the receipt by Dynasty Enterprise Group, LLC of written notice from the Department stating that Dynasty Enterprise Group, LLC has completed the remediation required by this Remediation Agreement in accordance with N.J.A.C. 7:26E and has satisfied all financial obligations imposed by this Remediation Agreement and therefore Dynasty Enterprise Group, LLC does not need to continue to maintain a remediation funding source or pay the annual 1% surcharge, and that no further action is necessary at the Site. The written notice shall also state that the Remediation Agreement is thereby terminated. Such written notice shall not relieve Dynasty Enterprise Group, LLC from the obligation to conduct future investigation or remediation activities pursuant to Federal, State or local laws for matters not addressed by this Remediation Agreement.

64. Except as provided in paragraph 52 above, Dynasty Enterprise Group, LLC may assert a claim of confidentiality for any information submitted by Dynasty Enterprise Group, LLC pursuant to this Remediation Agreement, by following the Department's procedures in N.J.A.C. 7:26B-7.

65. Dynasty Enterprise Group, LLC agrees to submit to the Department, one copy of the executed original Remediation Agreement, with the original signature of Dynasty Enterprise Group, LLC or its authorized representative, and documentary evidence such as a corporate resolution, or a certification by a corporate officer, that the signatory has the authority to bind Dynasty Enterprise Group, LLC to the terms of this Remediation Agreement, and proof that the remediation funding source has been established pursuant to N.J.A.C. 7:26C-7.

66. This Remediation Agreement shall be effective upon the execution of this Remediation Agreement by the Department and Dynasty Enterprise Group, LLC.

NEW JERSEY DEPARTMENT OF ENVIRONMENTAL PROTECTION

Date: 7-9-08 By: [signature]

Ronald T. Corcory, Assistant Director
Enforcement and Assignment Element

DYNASTY ENTERPRISE GROUP, LLC

Date: ______________ By: ______________

____
Print Full Name Signed Above

____
Title

ACKNOWLEDGEMENT OF SIGNATURE

State of New Jersey

County of Mercer

On this 9th day of July 2008, before me, the undersigned, personally appeared Ronald T. Corcory, the Assistant Director of the Enforcement and Assignment Element of the New Jersey Department of Environmental Protection, who, I am satisfied, is the person who signed the foregoing instrument, and he did acknowledge under oath that he signed and delivered the same in his capacity as such official, that he was authorized to execute the same on behalf of the New Jersey Department of Environmental Protection, and that the foregoing instrument is the voluntary act and deed of the New Jersey Department of Environmental Protection, made by virtue of proper authority.

Dwight Roskos

Signature of Notary/Seal

DWIGHT ROSKOS
NOTARY PUBLIC OF NEW JERSEY
Commission Expires 2/23/2012

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

Form 10-K

☑ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2011

Or

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission file number 1-892

GOODRICH CORPORATION

(Exact name of registrant as specified in its charter)

New York	34-0252680
(State of incorporation)	*(I.R.S. Employer Identification No.)*
Four Coliseum Centre 2730 West Tyvola Road Charlotte, North Carolina	28217
(Address of principal executive offices)	*(Zip Code)*

Registrant's telephone number, including area code: (704) 423-7000

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, $5 par value	New York Stock Exchange

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☑ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes ☐ No ☑

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☑ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☑ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

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

Large accelerated filer ☑	Accelerated filer ☐
Non-accelerated filer ☐ (Do not check if a smaller reporting company)	Smaller reporting company ☐

Indicate by check mark whether the registrant is a shell company filer (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☑

The aggregate market value of the voting and non-voting common equity of the registrant, consisting solely of common stock, held by nonaffiliates of the registrant as of June 30, 2011 was $11.9 billion.

The number of shares of common stock outstanding as of January 31, 2012 was 125,801,407 (excluding 14,000,000 shares held by a wholly owned subsidiary).

DOCUMENTS INCORPORATED BY REFERENCE: None

GOODRICH CORPORATION **EXHIBIT 21**

Parent and Subsidiaries of Registration

Consolidated Subsidiary Companies	Place Of Organization	Percentage Of Voting Securities Owned
Delavan Limited	United Kingdom	100.00
Goodrich Holdings Inc	Delaware	100.00
Goodrich Landing Gear, LLC	Delaware	100.00
Menasco Aerosystems, Inc.	Delaware	100.00
Goodrich Singapore, Inc.	Delaware	100.00
Goodrich International Service Corporation	New York	100.00
International Goodrich Technology Corporation	Delaware	100.00
Goodrich FSC, Inc.	Barbados	100.00
Ithaco Space Systems Inc.	Delaware	100.00
JMS I Corporation	Delaware	100.00
Goedrijk Finance C.V.	The Netherlands	100.00
GF Finance LLC	Delaware	100.00
Goedrijk Finance C.V.	The Netherlands	100.00
Kalama Specialty Chemicals, Inc.	Washington	100.00
Kinsman Road Realty Corporation	Ohio	100.00
Rohr, Inc	Delaware	100.00
Goodrich Aerospace Pty. Limited	Australia	100.00
Goodrich Aerostructures Integration Services, Inc.	Delaware	100.00
Tolo Incorporated	California	100.00
Rohr, Inc.	Maine	100.00
Rohr Industries, Inc.	Kentucky	100.00
Rohr International Sales Corporation	Delaware	100.00
Rohr International Service Corporation	Delaware	100.00
RE Components Inc.	Delaware	100.00
Rohr Finance Corporation	Delaware	100.00
Rohr Southern Industries, Inc.	Delaware	100.00
Goodrich Aerospace Europe S.A.S.	France	.03
TSA-rina Holding B.V.	The Netherlands	100.00
Goodrich Aerospace Europe, Inc.	Delaware	100.00
Goodrich Aerospace Europe GmbH	Germany	100.00
Goodrich Luxembourg S.C.S.	Luxembourg	50.00
Goodrich Aftermarket (Singapore) S.à.r.l.	Luxembourg	100.00
HEJ Holding, Inc.	Delaware	100.00
Goodrich (Gibraltar) Holding Limited	Gibraltar	100.00
Goodrich TMM Luxembourg B.V.	The Netherlands	100.00
Goodrich XCH Luxembourg B.V.	The Netherlands	100.00
Goodrich Aerospace de Mexico S.de R.L de C.V.	Mexico	.10
Goodrich Aerospace Properties S. de. R.L. de. C.V.	Mexico	.10
Goodrich Mexicali S.à.r.l.	Luxembourg	100.00
Goodrich Aerospace de Mexico S. de R.L de C.V.	Mexico	99.90
Goodrich Aerospace Properties S. de. R.L. de C.V.	Mexico	99.90
Goodrich Luxembourg S.à.r.l.	Luxembourg	100.00
Goodrich Finance S.à.r.l.	Luxembourg	100.00

CORPORATE HISTORY AFFIDAVIT
NOVEON HILTON DAVIS, INC.

STATE OF OHIO)
) SS.
COUNTY OF LAKE)

Affiant, Leslie M. Reynolds, of lawful age and having been duly sworn, states as follows:

1. I am the Secretary of Noveon Hilton Davis, Inc., a Delaware corporation (the "Corporation"), and I have custody of the corporate records pertaining to the corporate history of the Corporation, improperly served as Emerald Hilton Davis in the case captioned *Maxus Energy Corporation, et al., v. American Cyanamid, et al.*, Docket No. L-9869-05 (PASR), pending in the Superior Court of New Jersey, Law Division: Essex County.

2. Upon information and belief, the site located at 120 Lister Avenue, Newark, New Jersey, Block 2438, Lot 56 (the "Property"), was owned by The SDI Divestiture Corp. in 1993.

3. On October 20, 1986, the Corporation was formed in Delaware as "H.D. Acquisition Corp."

4. On January 13, 1987, the Corporation changed its name from "H.D. Acquisition Corp." to "Hilton Davis Chemical Co."

5. On September 9, 1993, the Property was transferred from The SDI Divestiture Corp., an Ohio corporation, formerly known as The Hilton-Davis Chemical Co., to the Corporation.

6. On June 24, 1997, the Corporation transferred ownership and certain liabilities of the Property to Drum Service of Newark, Inc.

7. In 1998, Freedom Chemical Company, including its subsidiary, the Corporation, was acquired by The B.F. Goodrich Company (now Goodrich Corporation)("Goodrich").

8. On March 16, 1998, the Corporation changed its name from "Hilton Davis Chemical Co." to "BFGoodrich Hilton Davis, Inc."

9. As a result of the 1998 acquisition of Freedom Chemical Company, Goodrich agreed to retain certain environmental liabilities relating to the Property from 1986 until 1996.

10. On May 24, 2001, the Corporation changed its name from "BFGoodrich Hilton Davis, Inc." to "Noveon Hilton Davis, Inc."

11. In 2006, Emerald Hilton Davis, LLC, formerly known as SPM D&D, LLC, a Delaware limited liability company, acquired certain assets of the Corporation.

12. Emerald Hilton Davis, LLC, a subsidiary of Emerald Performance Materials, LLC has its principal place of business at 2020 Front Street, Suite 100, Cuyahoga Falls, OH 44221 and has no liability in connection with the Property.

13. Noveon Hilton Davis, Inc. is the proper corporation for service in the pending lawsuit.

FURTHER THE AFFIANT SAYETH NAUGHT.

Leslie M. Reynolds

Leslie M. Reynolds, Secretary

Sworn to and subscribed before me, a Notary Public, on this 18th day of February, 2011.

Teresan Gilbert

Notary Public

NOTARIAL SEAL
STATE OF OHIO

TERESAN W. GILBERT
Attorney At Law
NOTARY PUBLIC
STATE OF OHIO
My Commission Has
No Expiration Date
Section 147.03 O.R.C.

NEW JERSEY DEPARTMENT OF ENVIRONMENTAL PROTECTION, THE COMMISSIONER OF THE NEW JERSEY DEPARTMENT OF ENVIRONMENTAL PROTECTION, and THE ADMINISTRATOR OF THE NEW JERSEY SPILL COMPENSATION FUND,	:	SUPERIOR COURT OF NEW JERSEY LAW DIVISION ESSEX COUNTY DOCKET NO.: ESX-L-9868-05 (PASR) <u>CIVIL ACTION</u>
Plaintiffs,	:	
v.	:	**CERTIFICATION OF RODNEY P. JENKS, JR.**
OCCIDENTAL CHEMICAL CORPORATION, TIERRA SOLUTIONS, INC., MAXUS ENERGY CORPORATION, REPSOL YPF, S.A., YPF, S.A.; YPF HOLDINGS, INC. and CLH HOLDINGS, INC.,	:	
Defendants.	:	

1. My name is Rodney P. Jenks, Jr. I am over the age of 18 years and competent to make this statement. The following statements are true and correct to the best of my knowledge and understanding and are made based upon my personal knowledge, information available to me from persons with personal knowledge, or are derived from business records. I am the Assistant General Counsel of Hexcel Corporation ("Hexcel").

2. Hexcel is a third-party defendant in the captioned litigation and currently is the owner of a nearly three acre parcel located at 205 Main Street in Lodi, New Jersey. This parcel is referenced as the "Hexcel Site" in Third Party Complaint B.

3. In December 1985, Hexcel entered into an agreement to sell the Hexcel Site to a entity known as FOA Corporation. The sale was completed in approximately March 1986. Subsequent to the closing date, FOA Corporation changed its name to Fine Organics Corporation. Fine Organics Corporation operated the Hexcel Site from March 1986 until such time that Hexcel reacquired the site from Fine Organics.

4. Fine Organics Corporation also is a third party defendant in the captioned litigation and is named as a party associated with the Hexcel Site in Third Party Complaint B.

5. Hexcel repurchased the Hexcel Site from Fine Organics Corporation in 1997 solely to mitigate potential environmental liabilities by obtaining direct control over the site; however, manufacturing and storage operations were not recommenced.

6. As part of its repurchase of the Hexcel Site, Hexcel entered into a settlement agreement with Fine Organics dated March 21, 1997, through which Hexcel agreed to defend, indemnify and hold harmless Fine Organics Corporation from environmental claims such as those alleged in the captioned suit (the "Indemnity").

7. Hexcel has acted pursuant to the Indemnity by defending and indemnifying Fine Organics Corporation in the captioned litigation. Pursuant to the Indemnity, Hexcel also will pay sums due for both Hexcel and Fine Organics Corporation pursuant to the proposed Consent Judgment between the State of New Jersey and third party defendants.

Dated at Stamford, CT, this 12th day of March 2013.

Rodney P. Jenks, Jr.

Subscribed and sworn before me this 12th day of March 2013.

Joyce R. Kantor

Notary Public

My Commission expires: August 31, 2016

Joyce R. Kantor
Notary Public-Connecticut
My Commission Expires
August 31, 2016

NEW JERSEY DEPARTMENT OF ENVIRONMENTAL PROTECTION, THE COMMISSIONER OF THE NEW JERSEY DEPARTMENT OF ENVIRONMENTAL PROTECTION and THE ADMINISTRATOR OF THE NEW JERSEY SPILL COMPENSATION FUND,

Plaintiffs

v.

OCCIDENTAL CHEMICAL CORPORATION, TIERRA SOLUTIONS, INC., MAXUS ENERGY CORPORATION, REPSOL YPF, S.A., YPF, S.A., YPF HOLDINGS, INC. and CLH HOLDINGS, INC.,

Defendants.

MAXUS ENERGY CORPORATION and TIERRA SOLUTIONS, INC.,

Third-Party Plaintiffs,

v.

3M COMPANY, *et al.*,

Third-Party Defendants.

SUPERIOR COURT OF NEW JERSEY
LAW DIVISION: ESSEX COUNTY

DOCKET NO. L-9868-05 (PASR)

CIVIL ACTION

CERTIFICATION OF HONEYWELL INTERNATIONAL INC.

CERTIFICATION OF HONEYWELL INTERNATIONAL INC.

Honeywell International Inc. submits this certification to describe the relevant corporate history of, and the relationships among, Honeywell International Inc., Honeywell Specialty Materials, LLC, and Universal Oil Products Company with respect to the so-called Universal Oil Products Site at East Rutherford, NJ (as defined in paragraph 2885 in Maxus Energy Corporation's and Tierra Solutions, Inc.'s Third Party Complaint B, filed February 4, 2009, and referred to herein as "the UOP Site").

I. Honeywell International Inc.

Currently, Honeywell International Inc. is the direct parent of Honeywell Specialty Materials, LLC and the indirect parent of Universal Oil Products Company.

II. Honeywell Specialty Materials, LLC

Honeywell Specialty Materials, LLC assumed the liabilities of EM Sector Holdings, Inc. before EM Sector Holdings, Inc. dissolved in 1999. EM Sector Holdings, Inc. was incorporated in 1932 as Universal Oil Products Company, merged with Trubeck Laboratories in 1963, and through various name changes ultimately became known as EM Sector Holdings, Inc. Currently, Honeywell Specialty Materials, LLC is both a wholly-owned subsidiary of Honeywell International Inc. and the indirect parent of Universal Oil Products Company.

III. Universal Oil Products Company

Universal Oil Products Company was incorporated in February 1975 as UOP Inc., changed its name to Universal Oil Products Company in July 1975, and currently is an indirect wholly-owned subsidiary of both Honeywell Specialty Materials, LLC and Honeywell International Inc. The Universal Oil Products Company has never owned or operated the UOP Site.

SETTLING THIRD-PARTY DEFENDANT

Honeywell International Inc.

BY: John J. Morris

John J. Morris

DATE: March 19, 2013

McCarter & English, LLP
Ira Gottlieb
Cynthia Betz
100 Mulberry Street
4 Gateway Center
Newark, NJ 07102
973-622-4444

Attorneys for Third-Party Defendants,
ICI Americas Inc. and Akzo Nobel Coatings Inc.

NEW JERSEY DEPARTMENT OF ENVIRONMENTAL PROTECTION, ET AL., Plaintiffs, v. OCCIDENTAL CHEMICAL CORPORATION, ET AL., Defendants. MAXUS ENERGY CORPORATION, ET AL., Third Party Plaintiffs, v. 3M COMPANY, ET AL., Third Party Defendants.	SUPERIOR COURT OF NEW JERSEY LAW DIVISION: ESSEX COUNTY DOCKET NO. L-009868-05 (PASR) Civil Action **CERTIFICATION OF CHARLES S.K. SCUDDER**

CHARLES S.K. SCUDDER, of full age, certifies and says:

1. I serve as the Corporate Secretary of Third-Party Defendants Akzo Nobel Coatings Inc. and ICI Americas Inc. I also serve as an Assistant General Counsel of Akzo Nobel Inc. This Certification is based on my personal knowledge and on the business records of Akzo Nobel Coatings Inc. and ICI Americas Inc.

2. I make this Certification in support of Akzo Nobel Coatings Inc.'s and ICI Americas Inc.'s request to be treated as Affiliated Entities for purposes of settlement of this action.

3. Akzo Nobel Coatings Inc. and ICI Americas Inc. are directly or indirectly wholly-owned by the same parent company, Akzo Nobel Inc., which is the holding company for all of Akzo Nobel N.V.'s activities in the United States.

4. Akzo Nobel Coatings Inc. is an indirect subsidiary of Akzo Nobel Inc.

5. ICI Americas Inc. is a direct subsidiary of Akzo Nobel Inc.

6. I certify that the foregoing statements made by me are true. I am aware that if any of the foregoing statements made by me are willfully false, I am subject to punishment.

Charles S.K. Scudder

Dated: March 8, 2013

Wolff & Samson PC
The Offices at Crystal Lake
One Boland Drive
West Orange, New Jersey 07052
973-325-1500
Attorneys for Third-Party Defendants,
IMTT-Bayonne and Bayonne Industries, Inc.

NEW JERSEY DEPARTMENT OF ENVIRONMENTAL PROTECTION, ET AL., Plaintiffs, v. OCCIDENTAL CHEMICAL CORPORATION, ET AL., Defendants. MAXUS ENERGY CORPORATION, ET AL., Third Party Plaintiffs, v. 3M COMPANY, ET AL., Third Party Defendants.	SUPERIOR COURT OF NEW JERSEY LAW DIVISION: ESSEX COUNTY DOCKET NO. L-009868-05 Civil Action **CERTIFICATION OF AFFILIATE STATUS**

DENNIS M. TOFT, of full age, certifies as follows:

1. I am an attorney-at –law of the State of New Jersey and a member of the firm of Wolff & Samson PC, the attorneys for IMTT-Bayonne and Bayonne Industries, Inc. in the above captioned matter. I have represented both IMTT-Bayonne and Bayonne Industries in various matters for a number of years and have personal knowledge of the facts stated herein.

2. IMTT-Bayonne is a partnership and Bayonne Industries, Inc is a corporation. Bayonne Industries Inc is the owner of the site in Bayonne, NJ which is the subject

of this action. IMTT-Bayonne is the operator of that site. The partners of IMTT-Bayonne and the shareholders of Bayonne Industries have ultimate common ownership. For these reasons IMTT-Bayonne and Bayonne Industries are affiliates for purposes of this matter.

3. The foregoing statements made by me are true; I am aware that if any such statement is willfully false I am subject to punishment.

Dated: 4/3/13

DENNIS M. TOFT

3891684.1

ITT CORPORATION 2011 ANNUAL REPORT

NEXT

ITT

ENGINEERED FOR LIFE

Successful companies are never satisfied with the way things are now and are always asking themselves **"What's next?"** At ITT, we are dedicated to discovering the best way forward with leading business strategies and sustainable customer solutions.

Our path is based on who we are – a diversified global company that provides highly engineered and customized technology solutions for growing end markets, including oil and gas, general industrial, aerospace and transportation.

We have a strong portfolio of businesses that are leaders in attractive and defensible niches, long-standing brands and channels, and a profile that is characterized by balance and diversity across all our businesses, market cycles and geographies.

Our portfolio is aligned with enduring, global growth drivers – urbanization, a growing middle class and sustainable development – and the ITT team has the experience and energy to harness this potential.

Every day, our employees bring extraordinary commitment and focus to creating enduring solutions for the essential industries that underpin modern life.

11%
2011 revenue growth

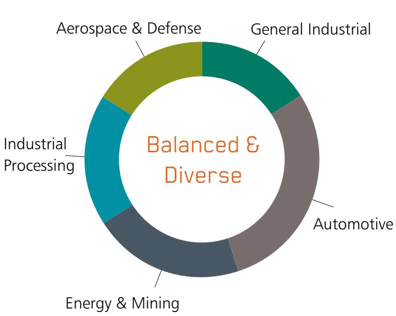
19%
2011 emerging market growth

20%
2011 adjusted segment operating income growth*

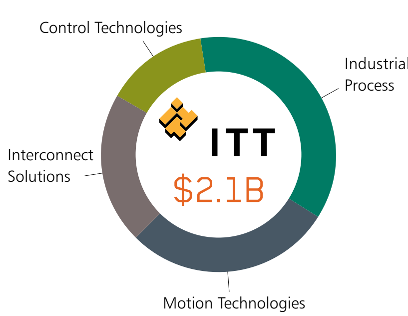
23%
2011 adjusted pro forma EPS growth*

Balanced and Diversified

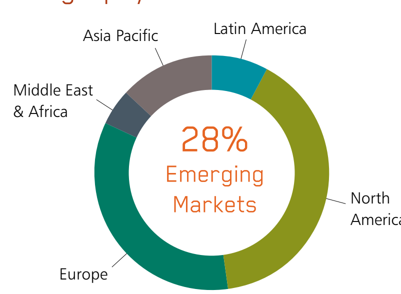
End Markets



Business Mix



Geography



Charts represent 2011 revenue mix.

** For a reconciliation of non-GAAP to GAAP results, please see our website at itt.com/investors.*

Dear Shareowners, Employees, Customers and Friends,

In life and in business, change usually comes so quietly and gradually that we only notice when we look backward and connect the dots. But, every once in a while, we are lucky enough to experience moments so powerful that we know with certainty that something extraordinary is happening – right now! – and that we are entering an exciting new chapter of our story.

Denise L. Ramos, Chief Executive Officer and President

ITT is in the midst of just such a metamorphosis. In 2011, we spun off our defense and water businesses, and became both a "new company" and one with a long and storied heritage. Today, we are more focused, with a better defined core group of customers and more synergies and similarities between our businesses.

Ours is a unique and enviable position. We have the freedom to re-imagine our company, based on a solid foundation that will serve us well as we shape the next great era of ITT. We are naturally looking ahead to what's next. But it's important to mark our starting point as well.

We have a clear vision of where the world's key industries are heading and how we can help them get there.

2011 performance results

Today, ITT is composed of four business units — Industrial Process, Motion Technologies, Interconnect Solutions and Control Technologies — that create highly engineered solutions for our customers' most critical applications.

Looking at our "new ITT" as a standalone company in 2011, we posted premier operating results. Revenues increased 11 percent to $2.1 billion with strong gains in fast-growing and emerging markets. Orders were up 16 percent and we had a record backlog at year end.

Our adjusted segment operating income increased 20 percent, reflecting solid operating margin expansion and demonstrating our growth potential.*

These results — achieved even under the pressure of the spin-off — show that we are a company built for growth and value creation. It's in our DNA.

Driving premier growth

In the long term, we are targeting a 5 to 7 percent increase in organic revenue and operating EBIT margin growth of 50 to 70 basis points. Our goal is to deliver free cash flow at 105 percent of net income, and our earnings per share growth target is 10 to 15 percent over the long term.

The engine that will drive our growth has six powerful pistons propelling our climb.

The first growth driver is our strong presence in high-growth and emerging markets, where we grew 19 percent in 2011 and have recently made several significant investments. With the oil and gas market booming in Brazil, we expanded and upgraded our Salto plant to better reach — and satisfy — customers in the fast-expanding Latin American region. And in China, we recently began construction on a $10 million research, development and production center in Wuxi that will bring new brake pad technologies to the No. 1 auto market in the world. We will continue to expand our footprint by going where our customers are — and where the growth will be.

We're also very strong in the profitable aftermarket segment, which drives recurring revenue streams. Our relationships with our customers endure through the life of their ITT products, and they know they can rely on us for valued service and replacement parts. For us, the aftermarket is not an afterthought. This is a high-growth business that represents

** For a reconciliation of non-GAAP to GAAP results, please see our website at itt.com/investors.*

a significant portion of our operating income, and our aftermarket topline growth increased by 12 percent in 2011, driven by our strong relationships with customers in the oil and gas, and aerospace markets.

ITT's third growth driver is an ongoing investment in technology and R&D to facilitate new platform and project wins that will drive incremental growth. We already spend on average about 1.3 times more on R&D than our peers. In 2011, a number of new ITT products hit the market, including the Goulds XHD Heavy Duty Pump, which is expected to set new industry standards for performance and efficiency, and our ECO series of high-performance shock absorbers, which offer industry-leading environmental benefits. Long term, we expect to grow revenues from new products by 30 percent.

We recognize that leading with technology alone will not fully differentiate our company. We work hard to combine our advanced technological solutions with a premier customer experience. That means that we embrace a retail mindset in an industrial company — driving toward industry-leading performance on measures such as quality, on-time delivery, production time and inventory turns. And, we seek to meet our customers' unspoken needs, turning "what ifs" into realities.

This premier customer experience will be enhanced by what ITT is known for — operational excellence. In 2011 alone, we achieved $90 million in gross productivity savings due to our focus on initiatives such as Lean Six Sigma and global strategic sourcing. In all we do, we're holding ourselves accountable to clear metrics to measure improvements in this area. While there is more work to be done, we are driven by lean value-based thinking that promotes continuous improvement and cost savings throughout the organization.

Finally, our growth will be fueled by effective capital deployment to drive organic and inorganic growth. Our approach is reflected in the investments we made in 2011 and the ones we will fund in 2012. For acquisitions, we will continue to look at targets between $15 million and $50 million in revenue that complement our existing businesses, core strategies and technology platforms. Our 2011 acquisition of Blakers Pump Engineers in Australia is a perfect example of this strategy. It hit the target revenue, it was in the right end markets of oil and gas and mining, and it addressed a growing market demand.

At ITT, we have a history of making smart investment decisions that deliver value, and we have a history of being disciplined in our approach. That will continue.

A passionate pursuit of excellence with a human touch

As we have demonstrated, ITT is a dynamic company. Change doesn't faze us — it energizes us. When you remember that our people invented the world's first all-iron pump, seamlessly moved from leather horse harnesses to parts for the earliest cars, and helped make possible the first talking movies and manned space missions, you know we are creative doers who embrace every opportunity to lead with technology, differentiate with customers and optimize our operations.

I couldn't be more proud to be leading this team of high achievers. Every day, our 8,500 employees around the globe roll up their sleeves and get down to the business of solving some of the hardest technical challenges our society confronts. And, we do it while embracing our core values of respect, responsibility and integrity. For me, our talented work force and leadership team's commitment to execution are as important as any strategy in achieving our goals and realizing the true value of ITT.

I also couldn't be more proud to be associated with our deep, diverse and engaged Board of Directors. With five new members — Orlando Ashford, Peter D'Aloia, Donald DeFossett Jr., Donald Stebbins and myself — we have an ideal blend of new voices and experienced leadership. The invaluable insight and perspective we received through the spin-off is early evidence that we will have the guidance we need to achieve our most aggressive goals.

Ready for what's next

The future belongs to those who can see it coming. At ITT, we have a clear vision of where the world's key industries are heading and how we can help them get there. Right now, we're developing technologies for tomorrow's challenges and implementing strategies to keep us in step with the accelerating pace of change.

It's a relentless race, but we're driven by the same inner fire that spurred ITT people through the past century to change the face of entire industries. Like them, today's ITT will have an enduring impact on the markets where we compete and on the world as a whole. When people everywhere fly, drive, communicate, turn on a light switch, run factories, and feel comfortable and safe, it's because ITT is on the case.

We've proven that we know what it takes to succeed today, and we truly are ready for what's next.

Sincerely,

Denise L. Ramos
Chief Executive Officer and President

Industrial

The manufacturing sector is the beating heart of the global economy. With ITT technologies, customers are producing more products than just a few years ago.

Manufacturing output is on the upswing around the world, including China and the United States, which account for more than a third of all global manufacturing. A recent survey by The Economist Intelligence Unit found manufacturing executives are increasingly shifting their focus from cost containment to make top-line growth a priority.

In factories and production plants across the globe, ITT is a valued growth partner. Whether we're helping customers handle corrosive chemicals, or solve complex manufacturing issues, or provide enduring infrastructure, we offer customized solutions to our customers around the world.

Our process pumps move vital fluids through factories, machining shops and biopharmaceutical laboratories. Our connectors help customers keep pace in a world where there's an ever growing need for speed. Our industrial shock absorption, motion control and rate control devices provide stability and protect against the shaking and vibrations that are often part of the industrial environment.

Our focus in all cases is to offer durable and reliable solutions that marry high value with low life-cycle costs for our customers around the globe. This is one of the main reasons we continue to enhance our enduring relationships with customers and provide the customized products and services that support their continued growth.

Next Generation Technologies

Our ECO Series hydraulic shock absorbers offer industry-leading environmental benefits by using biodegradable fluids and complying with the RoHS standard.

Our new Goulds XHD Slurry Pump has five patent or patent-pending features that enable coal mining companies to handle the heaviest ore-and-water mixtures as they extract another important fuel.

Our Enidine industrial shock absorbers provide controlled deceleration at up to 300 inches per second for longer machine life, safer machine operation and improved production quality.

Our PRO Services facilities provide strong aftermarket support for our industrial process pumps, with field service, engineering upgrades, inventory management and equipment rotation.

Oil and Gas

The energy industry is on the upswing, and we're providing smart and tough technologies that let our customers find, move and process the fuels we all need.

Energy makes modern life possible, and most of what we use to run our homes, businesses, cars and cities is generated by oil, gas and coal.

During the next 25 years, global energy demand is expected to grow by more than 50 percent. While developed nations will continue to need a steady flow of these fuels, the thirst in emerging markets will also be growing at a rapid pace.

ITT's durable and reliable products are designed for the harsh realities of this industry and give customers the capabilities they need to keep up with this growth surge.

Over the past few years, we have enhanced our portfolio of pumping systems, including the recently upgraded 7200 CB to the API 11th edition, and expanded our production, service and engineering presence in places such as India, Saudi Arabia and Brazil — becoming more of a partner than a provider to key global customers. Other products fueling our growth include our engineered valves and C'Treat reverse osmosis water systems.

By putting our energy into new and better solutions, we have steadily enhanced our position in this critical global end market, and we expect to continue to grow with our customers as they meet the continued demand for energy around the world.

Next Generation Technologies

Our intelligent ProSmart technology allows our customers to monitor their pumps remotely so they can detect issues and solve problems before they become catastrophic.

Enidine pipe restraints are used on critical piping systems to prevent damage caused by unwanted shock and vibration.

Our BIW electrical power connector technology can operate in extreme temperatures and pressures, making it a market leader in wells that use high-temperature steam to produce oil from tar sands.

Our engineered valves — some weighing up to 800 pounds — control the flow of everything from coarse slurry to fine froth for companies mining and processing Canada's oil sands.

Aerospace

The runway for growth in the global aerospace market is wide open, and ITT has the right mix of technologies to really take off.

Like a plane climbing through cloud cover, the commercial aerospace industry is surrounded by blue-sky projections of continued growth. In fact, global air traffic is expected to grow by approximately 5 percent a year for the foreseeable future and double by the year 2025, according to the International Civil Aviation Organization.

At ITT, we're helping airplane manufacturers meet this demand by providing lightweight, reliable products that aerospace engineers demand and passengers and flight crews deserve.

Walk through the cabin of almost any commercial airliner and you'll come in contact with hundreds of ITT components, from actuators and dampers that control the overhead stowage bins to hydro-mechanical devices that allow seats to recline and return to the upright position with the simple touch of a button.

With ITT components on board, airlines can also deliver the right kinds of sights, sounds and air quality to passengers. Our connectors are part of in-flight entertainment systems. Our valves and switches are part of cabin pressure and ventilation systems. Our custom-engineered components minimize noise and vibrations.

Over the years, we've earned our wings with aerospace customers, and we are well positioned to continue building on our strong partnerships as this industry reaches new heights.

Next Generation Technologies

Our innovative damping solutions reduce harmful vibrations and allow critical aircraft systems, such as the overheat detection system, to function properly.

Our innovative fuel line actuators use light instead of electricity to control the component, thus eliminating the possibility of fuel ignition.

Our communication cable assemblies helped Japan's Hayabusa space probe to become the first-ever mission to make a successful round-trip — including a landing — to a distant asteroid.

Our new composite connectors offer customers better corrosion resistance and up to 50 percent less weight than aluminum components, a key feature for today's light and fast planes.

Auto and Rail

Wheels are in motion – on the roads, on the rails and in our research laboratories, where we're coming up with new technologies for the growing transportation market.

Just a few short years after it may have seemed stalled, the global automotive industry is projecting healthy acceleration in the near term. A major driver is the expanding global middle class. This segment of the car buying population is projected to reach 1.2 billion people by 2030, with much of that expansion coming from China, India and other fast-growing markets.

Rail traffic is moving ahead, too. In the past year, both freight and passenger transport got back on track as the economic and trade recovery continued. And, growth is expected to keep on chugging. Looking ahead to 2020, global rail freight in India is expected to increase by 70 percent and global passenger traffic is expected to increase by 60 percent.

ITT is poised to support this growth as a leading supplier of braking technologies for automakers, as well as shock absorbers and dampers for the public transportation sectors. We also are tuned into the needs of the expanding electric vehicle market through our specialized connectors.

We're winning positions on the new breed of vehicles because we have proven ourselves — time and time again — in the transportation market. With surging urban growth and a growing middle class around the world, the demand for ITT's products and solutions will continue to expand.

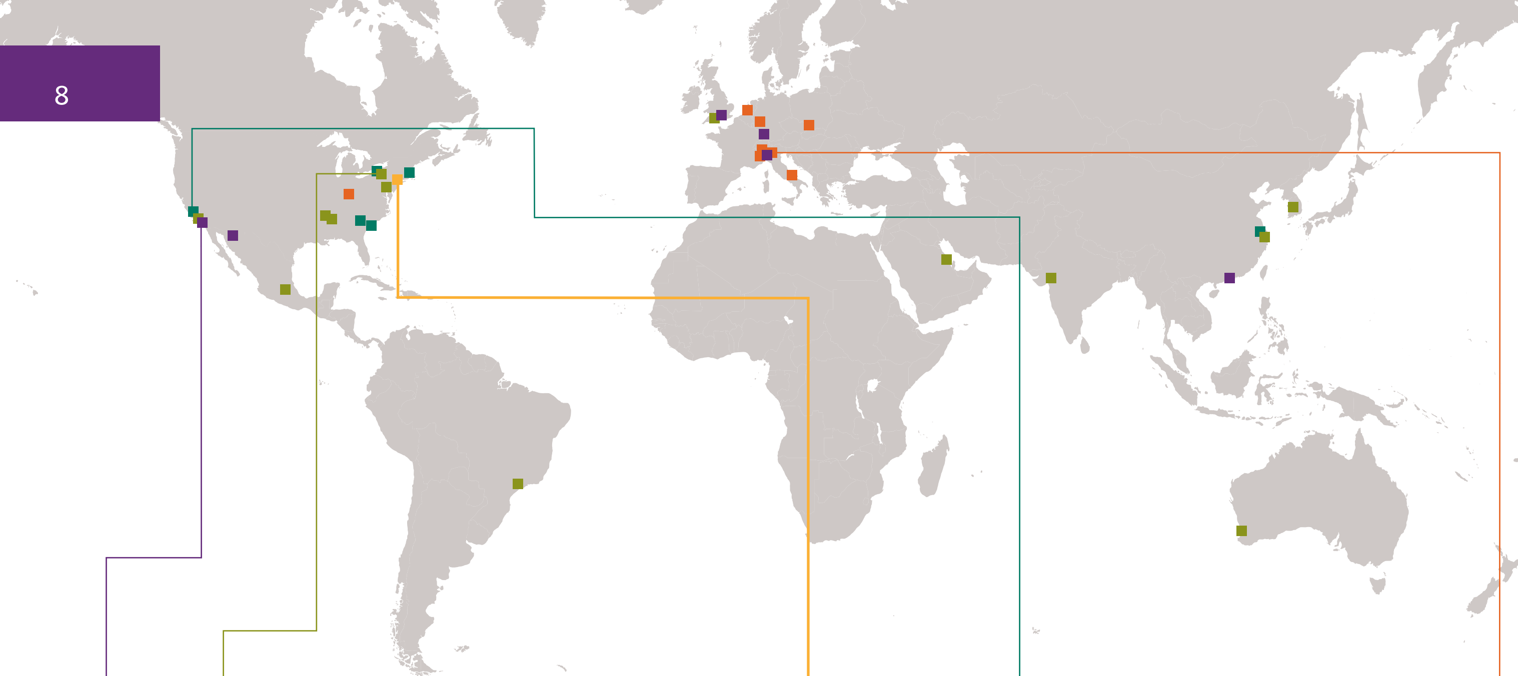
Next Generation Technologies

Our patent-pending Enidamp™ tubes reduce vibrations on freight rail cars — decreasing broken bolts and out of service cars — for railway customers.

A new line of brake pads with low or zero copper mixes and organic and recycled materials will enable customers to stay in line with new environmental regulations.

Our frequency selective damping (FSD) bus and car shock absorber is the industry's first to offer superior road handling without compromising comfort.

Our EVC connector earned a 2011 Readers' Choice award from Electronic Components News magazine for its ease of use and ability to charge electric cars faster than any other plug.



Industrial Process
Seneca Falls, NY
2,400 employees

Pumps, valves, monitoring and control systems, water treatment and aftermarket services for the chemical, oil and gas, mining, pulp and paper, power and biopharmaceutical markets.

- Amory, MS
- Axminster, U.K.
- Vadodara, India
- Cheongwon, South Korea
- City of Industry, CA
- Dammam, Saudi Arabia
- Lancaster, PA
- Perth, Australia
- Salto, Brazil
- Shanghai, China
- Southaven, MS
- Tizayuca, Mexico

Global Service Capabilities

Control Technologies
Valencia, CA
1,100 employees

Highly engineered motion control and vibration isolation products and solutions for the industrial, aviation, defense and rail markets.

- Billerica, MA
- Ladson, SC
- Orchard Park, NY
- Westminster, SC
- Wuxi, China

ITT

ENGINEERED FOR LIFE

ITT World Headquarters
White Plains, NY

ITT has more than 130 locations in 31 countries representing manufacturing, office and sales, and global service facilities, including the identified locations by segment.

Interconnect Solutions
Santa Ana, CA
2,400 employees

Connectors and interconnects for the telecommunications, military, aerospace, industrial, medical and transportation markets.

- Basingstoke, U.K.
- Lainate, Italy
- Nogales, Mexico
- Shenzhen, China
- Weinstadt, Germany

Motion Technologies
Lainate, Italy
2,200 employees

Shock absorbers, brake pads and friction materials for the automotive and rail markets.

- Barge, Italy
- Contrada Pantano, Italy
- Hebron, KY
- Kelsterbach, Germany
- Ostrava, Czech Republic
- Oud Beijerland, Netherlands
- Vauda, Italy

FORM 10-K
ANNUAL REPORT

Pursuant to Section 13 of the Securities Exchange Act of 1934
For The Fiscal Year Ended December 31, 2011

2011

ITT

Engineered for life

NOTICE

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

Form 10-K
ANNUAL REPORT

(Mark One)

☑ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2011

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Transition period from to

Commission File No. 1-5672

ITT CORPORATION

Incorporated in the State of Indiana | **13-5158950 (I.R.S. Employer Identification No.)**

1133 Westchester Avenue, White Plains, NY 10604
(Principal Executive Office)
Telephone Number: (914) 641-2000

Securities registered pursuant to Section 12(b) of the Act, all of which are registered on The New York Stock Exchange, Inc.:

COMMON STOCK, $1 PAR VALUE

Securities registered pursuant to Section 12(g) of the Act:

None.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☑ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☑

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☑ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files. Yes ☑ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☑

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

Large accelerated filer ☑ Accelerated filer ☐ Non-accelerated filer ☐ (Do not check if a smaller reporting company) Smaller reporting company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ☐ No ☑

The aggregate market value of the common stock of the registrant held by non-affiliates of the registrant on December 31, 2011 was approximately $1.8 billion. The December 31, 2011 measurement date was utilized due to the aggregate market value impact from the distribution of Exelis Inc. common stock and Xylem Inc. common stock on October 31, 2011.

As of February 10, 2012, there were outstanding 94.9 million shares of common stock, $1 par value, of the registrant.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's Definitive Proxy Statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A for its 2012 Annual Meeting of Shareholders are incorporated by reference in Part II and Part III of this Form 10-K.

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TABLE OF CONTENTS

* Included pursuant to Instruction 3 to Item 401(b) of Regulation S-K.

PART I

ITEM 1. DESCRIPTION OF BUSINESS

(In millions, except per share amounts, unless otherwise stated)

COMPANY OVERVIEW

ITT Corporation is a diversified manufacturer of highly engineered critical components and customized solutions for growing industrial end-markets such as energy infrastructure, electronics, aerospace and transportation. Building on its heritage of innovation, ITT partners with its customers to deliver enduring solutions to key industries. Founded in 1920, ITT is headquartered in White Plains, N.Y. with approximately 8,500 employees in 31 countries and sales in more than 100 countries. The company generated 2011 revenues of $2.1 billion.

We manufacture key components that are integral to the operation of systems and manufacturing processes in the electronics, energy & mining, transportation, aerospace, and industrial markets. Our products provide enabling functionality for applications where reliability and performance are critically important for our customers and the end users of their products. For example, our industrial pumps serve the critical function of transporting inorganic fluids throughout chemical processes at petrochemical plants. The pumps are critical to the production requirements of the customer's plant and their reliability helps our customers meet the delivery time and quality expectations of the end users of the petro-chemicals they produce.

ITT is a global company with a balanced and diversified portfolio, positioned to capitalize on secular macro trends such as urbanization and the growing middle class in emerging economies. In 2011, 63% of our sales were outside the United States, including 28% directly from emerging growth market economies. Further, approximately 30% of our revenue is derived from aftermarket products and services where we often capture repeat sales because of our large installed base of specialized products. Additionally, approximately 45% of our revenue is derived from positions our products hold on long-lived customer platforms. Similar to the aftermarket, these are also long-term recurring revenues.

Our product and service offerings are organized in four operating segments: Industrial Process, Motion Technologies, Interconnect Solutions (ICS), and Control Technologies. These businesses generally operate with strong niche positions in large, attractive markets where specialized engineered solutions are required to support large industrial and transportation customer needs.

Industrial Process manufactures engineered fluid process equipment serving a diversified mix of customers in global infrastructure industries such as oil & gas, mining, power generation, chemical and other process markets and is an aftermarket service provider.

Motion Technologies manufactures brake pad, shock absorber and damping technologies for the global automotive, truck, trailer and public bus and rail transportation markets.

Interconnect Solutions manufactures a wide range of highly specialized connector products that make it possible to transfer signal and power in various electronic devices that are utilized in aerospace, industrial, defense and oil & gas markets.

Control Technologies manufactures specialized equipment, including actuation, valves, switches, vibration isolation, custom-energy absorption, and regulators for the aerospace, military and industrial markets.

The table included below provides revenue results by segment for each of the last three years. See section titled "Segment Information" for further information about each of our business segments.

(In Millions)	**2011**	2010	2009
Industrial Process	**$ 767**	$ 694	$ 719
Motion Technologies	**634**	548	491
Interconnect Solutions	**418**	413	341
Control Technologies	**318**	275	243
Eliminations	**(18)**	(22)	(24)
Total consolidated revenue	**$2,119**	$1,908	$1,770

Unless the context otherwise indicates, references herein to "ITT," "the Company," and such words as "we," "us," and "our" include ITT Corporation and its subsidiaries. ITT Corporation was incorporated as ITT Industries, Inc. on September 5, 1995 in the State of Indiana. On July 1, 2006, ITT Industries, Inc. changed its name to ITT Corporation.

Company Transformation

On January 11, 2011, the Board of Directors of ITT approved a plan to separate ITT into three independent, publicly traded companies. On October 31, 2011 (the Distribution Date), ITT completed the tax-free spin-off of its Defense and Information Solutions business, Exelis Inc. (Exelis), and its water-related businesses, Xylem Inc. (Xylem) (referred to herein as the Distribution). We believe these three businesses are well-positioned to create value for shareholders as standalone companies.

ITT's Board of Directors determined that the Distribution would provide benefits to the Company, including: (i) greater strategic focus of financial resources and management's efforts, (ii) enhanced customer focus, (iii) direct and differentiated access to capital resources, (iv) enhanced investor choices by offering investment opportunities in separate entities, (v) improved management incentive tools, and

(vi) greater potential for utilization of stock as an acquisition currency.

Greater Strategic Focus of Financial Resources and Management's Efforts. Prior to the Distribution, ITT's businesses exhibited different financial and operating characteristics. In particular, the Exelis business was generally characterized by cycles that are comparatively lengthy relative to those of Xylem and ITT. This resulted in different capital expenditure and acquisition strategies. It was believed that management resources could be efficiently utilized if each management company concentrated solely on its set of businesses.

The Distribution allows management to more closely align their time and resources to operating each of these businesses.

Enhanced Customer Focus. As a unified, commonly managed set of industrial businesses, our management will be more able to focus on the needs of our customers and the specific end-markets and geographies they serve.

Direct and Differentiated Access to Capital Resources. Following the Distribution, we have the ability to focus our capital resource deployment on the remaining businesses. As a global industrial business with strong global cash flow generation potential, our business has different financial and operating characteristics from Exelis and Xylem. We believe that direct and differentiated access to capital resources will allow each company to better align each of their financial and operational characteristics with investor and market expectations.

Enhanced Investor Choices by Offering Investment Opportunities in Separate Entities. After the Distribution, investors should be better able to evaluate our financial performance, as well as our strategy within the context of our markets. We believe that the investment characteristics of ITT following the spin may appeal to different types of investors. As a result of the Distribution, our management should be able to implement goals and evaluate strategic opportunities in light of investor expectations within our various industries. In addition, we should be able to focus our public and investor relations efforts on cultivating a new identity.

Utilization of Stock as an Acquisition Currency. The Distribution will enable Exelis and Xylem to use their stock as currency to pursue certain financial and strategic objectives, including tax-free merger transactions. In addition, future strategic transactions with similar businesses will be more easily facilitated through the use of our stand-alone stock as consideration.

On October 31, 2011 (the Distribution Date), ITT completed the Distribution of Exelis and Xylem by way of a distribution of all of the issued and outstanding shares of Exelis common stock and Xylem common stock, on a pro rata basis, to ITT shareholders of record on October 17, 2011. Exelis and Xylem are now independent companies trading on the New York Stock Exchange under the symbols "XLS" and "XYL", respectively. The Distribution was made pursuant to a Distribution Agreement, dated October 25, 2011, among ITT, Exelis and Xylem (the Distribution Agreement). On the Distribution Date, ITT also affected a one-for-two reverse stock split of its common stock (the 1:2 Reverse Stock Split).

Following the Distribution, ITT did not own any shares of common stock of Exelis or Xylem. All information herein has been restated to reflect the Distribution, and the results of the distributed businesses are presented as discontinued operations for all periods.

Business Strengths and Strategies

Management believes that the Company has several distinct competitive advantages that allow it to sustain and grow its market positions.

ITT is a diversified industrial technology company with established businesses that share five unifying characteristics:

1. The design and manufacture of highly engineered products for critical applications
2. Leaders in attractive and defensible niches
3. Global footprint & highly diversified
4. Longstanding brands and operating history
5. Proven management system and leadership

As a result, these businesses share a common, repeatable operating model. Each business is a leader in applying its technology and engineering expertise to solve some of the most pressing challenges of our customers. Our applied engineering adeptness provides a strong business fit with our customers given the critical nature of their applications. This in turn provides us with a strong degree of knowledge of our customer's requirements and allows us to better determine how we can help them to achieve their business goals. Our technology and customer intimacy in tandem produce opportunities to capture recurring revenue streams, aftermarket opportunities and long lived original equipment manufacturer (OEM) platforms. ITT possesses a core competency at operating this unified model across businesses in order to create value. These businesses also tend to operate in varying economic business cycles, which reduces exposures to any one cycle.

The oil & gas business in our Industrial Process segment is representative of the capability that many of ITT's businesses have to generate profitable growth from our common operating model. In 2007 Industrial Process began to pursue growth in the oil & gas market because of its long-term attractiveness, our existing engineering capabilities, brand strength and the aftermarket potential. We started by investing in our technology through our product line expansion. We increased our footprint to achieve strategic proximity to our customers, including facilities in India in 2008, Saudi Arabia in 2009, and the acquisition of Canberra Pumps in Brazil in 2010. Additionally, we invested in upgrading and expanding our global test capabilities to accommodate high horsepower pumps that are used in this market. We have just recently completed a significant upgrade and expansion of our plant in Brazil and acquired our distributor in Australia to cover the expanding oil & gas market in that region. As a result of our operating model, over this time we have signed global oil & gas strategic account agreements with five globally recognized oil & gas customers.

ITT possesses leading brands in many of its niche markets such as Goulds Pumps, Cannon, KONI, Enidine and ITT. These brands are associated with quality, reliability, durability, and engineering excellence. Recently, the Company has extended its branding efforts internationally. As a result, the ITT brand is very well recognized in emerging markets including China, India, Brazil and Saudi Arabia.

In addition to branding efforts, we collectively utilize the well-established ITT Management System (IMS), which is a framework for running our businesses in a measureable, data-driven manner and is a guide for the behaviors, decisions and actions of our employees. The IMS consists of four core integrated processes:

1. Profitable Growth – Value based approach to organic growth through strategic planning, market segmentation, and new product development
2. Operational Excellence – Value Based Lean Six Sigma and goal deployment process for continuous, sustained cost reduction
3. Resource Optimization – Alignment of our production, sourcing, and footprint with our growth strategies
4. Leadership & Learning – Continuous training and development of our employees

We deploy the IMS in each of our operating segments and at each of our major facilities. In addition, we have implemented a system of integrated councils comprised of leaders from each business that focus on core growth and efficiency improvement areas across ITT. The focus areas are 1) Commercial Excellence; 2) Operational Excellence; 3) Technology; and 4) Global Sourcing. This collaborative approach provides us with the opportunity to leverage best practices and key resources in customer relationship management, coordinated sourcing initiatives, innovation, and technology sharing.

ITT's long-term objectives are to increase the Company's earnings and financial returns through a balanced operating strategy. The elements of this strategy are disciplined organic growth through global market expansion and new product development, combined with operational improvements through the ITT Management System that focus on reducing costs and cycle times and improving our productivity on a continual basis. We believe we can drive growth by helping our existing customers grow while seeking new customers by expanding our geographic and product markets. With the external focus of the ITT Management System our efforts at continuous improvement are centered on meeting and exceeding customer requirements.

Our long-term goals are to drive average annual organic revenue growth of approximately 5%-7%, with corresponding operating margin expansion of 50-70 basis points, achieve free cash flow conversion of greater than 105%, and adjusted EPS growth of 10%-15% per year. We intend to leverage our niche market positions, continue to expand globally by following and supporting our customers and their growth, introduce new products, and drive down costs and increase productivity to reach these goals.

ITT's growth strategy consists of the following six key elements, which collectively are expected to grow revenues, expand margins, and drive increased profitability and cash flow:

1. Premier Customer Experience

ITT places significant focus on managing the relationships it has with its customers through a formalized process known as Value-Based Commercial Excellence (VBCE). VBCE is a continuous improvement process which our businesses use to strategically price our products and services, develop our value propositions, and assist our customers to solve their toughest business challenges. ITT is able to accomplish this by providing an efficient and productive customer experience through advanced order configuration, on-time delivery initiatives, and reliable products and services. In addition, ITT has key strategic account relationships throughout the industries we serve. Strategic accounts are customer partnerships, often global in scale, which promote the shared benefits of improved business processes between ITT and its customers. Our strategic account agreements promote customer intimacy, optimized service and delivery performance, and provide growth and profit improvement opportunities. In some instances we are able to leverage these relationships across segments. For example, both Industrial Process and ICS supply products and services to certain oil & gas customers through Industrial Process's strategic account relationships. Additionally, ITT's Global Supply Chain Services (GSCS) capabilities and operational excellence initiatives are key supporting elements to the premier customer experience. The Company views its customer relationships as its primary vehicle for growth and technological advancement. Understanding our customer's growth plans and challenges allows ITT's businesses to tailor and deliver reliable and timely products and services.

2. Investment in Technology and Research & Development

The company has a core competency in application engineering because a majority of our products feature leading technologies that operate in harsh environments. Harsh environments reflect challenging surrounding conditions such as the extreme cold and darkness of outer space, the high pressure of the ocean floor or within the confines of hand held communication devices that oftentimes are dropped on hard surfaces. For example, our electrical connectors are built specifically for service on satellites in space, in oil & gas drilling operations under sea and on land, and in popular mobile devices such as smart phones.

ITT has differentiated itself in the critical arena of technology and research & development (R&D). ITT has a strong track record in new product development and introduction. As a result of our investments, R&D as a percentage of sales has exceeded three percent during each of the last three years. ITT's approach to technology is to work with its customers in tailoring the right approach to a particular customer need or problem. In our Industrial Process business, our engineers work with our customers in a number of highly challenging environments to improve the way our pumps are installed and operated. This allows the customer to run their processes more reliably and use less energy since energy is the largest component of pump life cycle operating costs.

3. Focused Expansion in Growth Markets

ITT is a global company with 63% of its 2011 revenue derived from international markets, including 28% from emerging growth market economies. Accordingly, ITT has located approximately half of its manufacturing facilities outside of the United States to lower costs, achieve strategic proximity to its customers and to further increase international sales and market share. For example, ITT's ICS segment has had a long-term presence at its Shenzhen, Guangdong Province, China facility. Shenzhen is a low cost manufacturing site that also possesses component fabrication capabilities such as metal stamping, plating, machining and injection molding. Shenzhen produces products for both domestic consumption in China and for global customers. The plant and its experienced, skilled workforce produce a number of ICS products such as universal contacts, electric vehicle connectors, and medical connectors. In addition, the Shenzhen site is staffed with engineers who design specific products for the Asia Pacific and China region.

ITT's businesses are in a position to grow with its customers in these rapidly expanding global markets. Many of these markets are bolstered by secular trends driving development throughout the emerging economies such as a growing middle class and urbanization. These trends are fueling increased consumer consumption of energy, durable goods, automobiles, rail and air travel. For example, Goulds Pumps are used in processing petrochemicals in Saudi Arabia for use in a host of consumer goods such as plastics. Our Motion Technologies' brake pads are installed on Shanghai General Motors and Mercedes automobiles in China, and KONI rail dampers are making high speed trains more comfortable for passengers in China.

We have and expect to continue to expand our R&D capabilities to make products that are relevant to local markets. Our focus is on products where reliability and engineered solutions are valued. We recently added R&D technology centers in key markets such as India and China. In early 2012, we plan to begin development on another R&D center in China that will be focused on expanding and enhancing braking technologies for the local market. Industrial Process is developing localized ISO and multistage ring section pumps at our Baroda, India plant for the growing chemical process, oil & gas, and general industrial pump markets in India.

4. Increased Aftermarket Capture and Platform Expansion

Aftermarket sources accounted for approximately 30% of our 2011 revenue. Our Industrial Process, Motion Technologies, and Control Technologies segments benefit from repeat sales of original products, consumable spare parts, and services as a result of our large, global, and growing installed base of products. Aftermarket business generally carries higher margins than original sale products and tends to be a more stable, recurring revenue stream than project-based businesses. The key drivers of aftermarket demand are the wear and tear on critical components in harsh environmental applications. We develop our aftermarket business through our end user sales channels and dedicated service personnel. The Company views this as a valuable source of future earnings and is actively marketing its capabilities while investing in technologies that reduce the customer's total life cycle cost. For example, our Industrial Process business has an established international service center network with eight Pump Repair and Overhaul shops (PRO shops) in the United States and facilities in Australia, Brazil, Chile, Saudi Arabia, Thailand, and Venezuela.

Our Motion Technologies segment also has recurring revenue streams from automotive and rail platform content. Its products generally serve on long-term platforms whereby once the original equipment products are sold, aftermarket parts are needed to replace and extend the life of a vehicle. Our up-front investments to gain positions on automotive platforms provide long-term sustainable revenue. Another example of this is on various aerospace platforms where ICS has been supplying content for many decades.

5. Margin Expansion through Operational Excellence

The Company strives to increase its profit margins and improve its competitive position in all of its business segments through its operational excellence strategy. The core elements of this strategy are Value Based Lean Six Sigma (VBLSS), GSCS and shared service utilization. These strategies enable the company to realize operating efficiencies, increased customer satisfaction, and increased free cash flow while lowering operating costs, streamlining processes, eliminating waste and improving cycle times.

The ITT culture has long embraced Lean as its central operating tenet. VBLSS encompasses Lean manufacturing as well as continuous process improvement in other critical areas such as customer service and order entry and fulfillment. Our intent is to drive ever increasing levels of quality, speed, and efficiency.

GSCS which includes low cost region sourcing and production, has enabled us to mitigate inflation and increasing material costs in order to maintain or improve profitability during periods of rising costs. ITT produces its array of engineered products in key low-cost and emerging growth countries such as China, India, Brazil, Saudi Arabia, South Korea, Czech Republic and Mexico. Certain operations, including shared services are leveraged between the Company's operating segments which have resulted in additional cost savings and synergies through the consolidation of operations and reduced general and administrative expenses.

6. Effective Capital Deployment to Drive Organic and Inorganic Growth

ITT's businesses operate in growing and highly fragmented markets. ITT estimates the sum of its served addressable markets to be approximately $31 billion worldwide. Given these dynamics and ITT's technology investments, global reach and strong brands, the Company believes it has the opportunity to continue to expand geographically, broaden its product lines, improve its market share positions, and increase earnings through sales growth and operational efficiencies on an organic basis and through acquisition. We strive to effectively deploy our capital by combining strategic filters with rigorous financial criteria. ITT's acquisition strategy generally targets firms in similar businesses and end-markets that produce unique and differentiated products and technologies. A disciplined focus on liquidity and cash management is a major part of how we will manage ITT's financial performance.

Targeted Leverage Of Our Capabilities

In addition to the six key elements of the growth strategy described above, ITT will leverage its diverse set of resources and capabilities across its businesses in order to maximize the Company's value creation potential. The Company is continually evaluating cross business revenue growth and cost saving opportunities and views the following assets and capabilities as core to this mission:

- *ITT Brand* – The ITT brand is well regarded and widely recognized, particularly in global growth markets. This provides our segments with brand recognition for new products in key emerging growth market economies such as Brazil, China, and India.
- *IMS* – Increased performance and productivity through the common application of the ITT Management System.
- *Shared Services* – North American, Chinese and other regional shared services initiatives; including information technology.
- *Councils* – Cross value center operational councils in areas such as operations, commercial excellence, and technology and new product development. While our technologies vary significantly between each of our segments, our engineering leaders across the businesses leverage our collective strengths through collaboration and cooperation in areas such as design tooling, specific technologies and best practices including our long-standing, results-driven value-based product development process.
- *Strategic Accounts* – Further development and expansion of our global strategic account program to bring the combined technical capabilities of multiple ITT businesses to address incremental customer opportunities.
- *Sourcing* – Indirect sourcing activities across ITT's businesses are managed centrally to better leverage our third-party spending and vendor performance levels. ITT's global indirect sourcing group also provides services to Exelis and Xylem on a third-party contract basis. Generally these third-party contracts last for one to two years, but may be terminated earlier if either Exelis or Xylem source the services from an alternative provider.

Segment Information

Industrial Process

The Industrial Process segment is a global manufacturer of industrial pumps, valves and related equipment, and is a provider of plant optimization and efficiency solutions and aftermarket services and parts. Headquartered in Seneca Falls, New York, its operations include four product categories:

Goulds Pumps, Inc. is the largest operating division in the Industrial Process segment and is a market leader with over 160 years of product design history and is focused on customer needs primarily in the chemical, oil & gas, mining, power, pulp & paper, and general industrial markets. The Goulds Pumps brand is among the most widely recognized brands in the global pump industry. We have a broad portfolio of centrifugal pumps including ANSI and ISO chemical pumps, API (American Petroleum Institute) pumps for the petrochemical and oil & gas industry, slurry and process pumps for the mining industry and paper stock pumps for the pulp & paper industry. Our portfolio also includes vertical, axial flow, multi-stage and other pumps that are used in a multitude of industries.

ITT Engineered Valves is a manufacturer of process valves for the biopharmaceutical, mining, power, pulp and paper and general industrial markets. ITT Engineered Valves has 65 years of experience in design, fabrication and engineering of market leading industrial knife-gate (Fabri-Valve) and sanitary diaphragm valves (Pure-Flo). Pure-Flo is a leading provider of sanitary valves to the global biopharmaceutical market.

ITT PRO Services is the aftermarket solutions offering of Industrial Process which strives to extend equipment life in its customers' facilities. PRO Services provides an array of services focused on reducing equipment total cost of ownership (TCO) and increasing plant output. The typical services provided include parts supply, inventory optimization, field service, energy and reliability assessments, repairs, upgrades and overall equipment maintenance. PRO Services offerings include Goulds Pumps Parts, ProShop Repair and Upgrades, ProSmart, PumpSmart, ProCast and Plant Performance Services.

ITT C'treat is a leading provider of water treatment systems for offshore oil and gas production platforms and has been in business since 1980. Its skid-mounted, reverse osmosis water makers convert seawater to drinking water and process water for the world's largest offshore oil and gas exploration and production corporations.

Industrial Process services an extensive base of customers from large multi-national companies, engineering, procurement and construction firms (EPC) to regional distributors with thousands of end-user customers. We estimate this segment's served addressable market is approximately $12 billion worldwide. In 2011, the end-use markets that these customers operated in include oil & gas (29%), chemical & petrochemical (23%), mining (13%), and general industrial (35%). These customers are geographically distributed with a regional mix of North America (57%), Latin America (16%), Middle East & Africa (10%), Asia Pacific (12%) and Europe (5%).

Industrial Process has transformed its Goulds Pumps business considerably over the past five years. Goulds Pumps is an industry leader in the chemical, power, mining, paper and other pump segments, including food & beverage, biofuels, steel and many other industries. Key products include ANSI and ISO process pumps, paper stock, horizontal split case, sump, slurry and vertical turbine pumps. Investments have been made in this segment to automate the product selection and order entry process to drive highly efficient transactions and accuracy. In order to support more complex industrial pump segments which includes engineered to order API products for the global oil & gas, petro-chemical and power generation markets a great deal of investment has been made over the last decade. Industrial Process has been successful in penetrating this segment by investing in upgrading existing products and infrastructure, increasing engineering resources globally, enhancing global product and project management and driving operational excellence. Order fulfillment for the more complex segment often involves customization and multiple customer milestone meetings as they progress from order entry, manufacturing, testing, shipment, and installation and start-up.

Industrial Process recognizes that serving the customer before, during and after installation is critical. Our success in the marketplace is largely due to our global and diversified channel structures. End-users are serviced by an extensive network of independent industrial distributors and representatives which complement our customer-focused direct sales and service organization. We also have focused channels dedicated to supporting the EPC firms as their needs are often different from other end-user customers.

The pump and valve markets Industrial Process serves are highly competitive. For most of our products there are hundreds of regional competitors and a limited number of larger global peers. We consider our larger competitors to include Flowserve, Sulzer Pump, ClydeUnion (SPX), Ebara, Weir and Tyco (valves). Primary customer decision drivers include price, delivery, brand recognition/ reputation, perceived quality, broad product offerings, commercial terms, technical support and localization. Pricing is typically very competitive for large projects because of the increased potential for aftermarket opportunities for the original equipment provider.

Our ability to compete is based upon having a wide range of engineered industrial pumps to meet many of our customers' most demanding applications and on our capability to provide our customers with an array of after sale services and support. For larger projects, breadth of product offering is an important factor as it simplifies the customer procurement process. Industrial Process' ability to expand our product portfolio has historically been a competitive strength.

We benefit from our large global installed base of products, and because of the processes in which they are installed, require frequent maintenance, repair and replacement parts. The frequency of repair and maintenance services is dependent on utilization levels and the conditions and environment in which they operate. Our direct and distributor channels provide market leading service to our customers. As we increase the number our global installations, we continue to add service centers and personnel. By positioning our presence closer to customers, we are able to provide quick responses to their growing aftermarket needs.

We believe our Industrial Process segment demonstrates ITT's competency in Premier Customer Experience because the organization works with its customers over the life cycle of the installation and operation of its products in the customers' facilities or its customers' end users in the case of an EPC firm. Industrial Process is able to accomplish this because of its extensive global customer relationships, breadth of product offering, product availability, project management skills, and aftermarket and reliability services.

Motion Technologies

Motion Technologies, headquartered in Lainate, Italy, is a global manufacturer of highly engineered and durable components, consisting of brake pads, shock absorbers and damping technologies for the transportation industry. The transportation industry encompasses both personal and public transport equipment, such as passenger cars, light and heavy-duty commercial vehicles, buses and rail transportation. Motion Technologies consists of two businesses, Friction Technologies and KONI. Through its Friction Technologies business, Motion Technologies provides the automotive market with high-performance, high-quality brake pads and through its KONI business, Motion Technologies provides the transportation industry with shock absorber and damping equipment. The Motion Technologies revenue composition is split approximately 80% from Friction Technologies and 20% from KONI. Motion Technologies primarily serves the high-end of the transportation industry, with a strong reputation for quality products and a focus on new product development and operational excellence.

We believe that Motion Technologies is positioned and structured to benefit from the anticipated growth in the transportation industry. Growth that we believe will be driven by increasing urban and middle class populations, creating a significant need for additional mass transit infrastructure and individual desire for automobile ownership.

Friction Technologies

Our Friction Technologies business applies innovative research of new friction materials and the identification of highly productive technologies to produce a range of brake pads installed as original equipment (OE pads) on cars and light to heavy duty commercial vehicles. OE pads are sold either directly to original equipment manufacturers (OEM) or to Tier-1 and Tier-2 brake manufacturers. Our OE pads are designed to meet specific customer specifications and environmental regulations, and to satisfy an array of geographic applications. Most automobile OEM platforms (car model) require specific brake pad formulations based the customer's specifications, including demanding delivery and volume schedules.

Friction Technologies also manufactures aftermarket brake pads destined to the automotive service and repairs market. This market consisting of both OEM dealers, also referred to as original equipment service (OES) networks, and independent aftermarket (AM) networks. Brake pads sold within the OES network generally match the exact specifications of an original auto platform OE brake pad, while our robust catalogue of AM pads features technology designed to provide up to the highest levels of braking performance. Within the service and repairs market, pads are sold either directly to OEM manufacturers and to the Tier-1/Tier-2 brake manufacturers or indirectly through European distributors, primarily Continental. Combined sales to Continental and TRW, Motion Technologies' largest customers were 41% of 2011 revenue and 12% of consolidated ITT revenue.

Our dedication to customers and to the advancement of braking technologies has built a legacy of quality, reliable products that meet the demands of customers across the globe, creating our leadership position in the European OE pad and AE pad markets. Historically, revenue for Friction Technologies has been generally balanced between OE pads and AM pads.

KONI

The KONI business organizes its various performance shock absorber products into three main product market groups: railway rolling stock; car & racing; and bus truck & trailer. Each product market group is handled by its own dedicated team for product development and engineering, assembly lines and sales & marketing, thus assuring the best possible concentration of product specialization and know-how.

Railway Rolling Stock – The railway rolling stock market group provides a wide range of equipment for passenger rail, locomotives, freight cars, high speed trains and light rail.

Offerings include hydraulic shock absorbers (primary, lateral and inter-car), yaw dampers as well as visco-elastic and hydraulic buffers. This market group also engages in the revamping of air springs which are primarily used on high speed trains and light rail in the United States. Revenue opportunities for our rail damping systems are balanced between OE and AM customers. Sales are either directly to train manufacturers and train operators carrying out scheduled train maintenance programs or indirectly through distributors.

Car & Racing – The car & racing market group features performance shock absorbers using our Frequency Selective Damping (FSD) technology. FSD products are popular with car and racing enthusiasts who desire to modify their shock absorbers for increased handling performance. KONI car shock absorbers are sold all over the world, through a distribution network that markets KONI products into specific geographies or customer groups.

Bus, Truck & Trailer – The bus, truck and trailer market group manufactures shock absorbers and bus dampers, destined to both OE and AM customers.

The rail damping systems and bus dampers market, have attractive growth prospects because mass transit systems are benefiting from ongoing large-scale urbanization trends and infrastructure investments. The long-term, enduring nature of these factors fosters a market environment that tends to demonstrate mitigated levels of cyclicality. In addition, train and bus vehicles are sustainable transport modes that reduce traffic congestion and smog levels in urban areas.

Motion Technologies has a strong market reputation derived from many years of mutual collaboration with major OE manufacturers and is focused on customer satisfaction, quality and on-time delivery. Motion Technologies has a global manufacturing footprint, with production facilities in Western Europe, Eastern Europe, North America and Asia. Although 41% of Motion Technologies revenue is derived from its top two customers, demand for its products stems from a variety of end customers all over the world.

Motion Technologies competes in markets primarily constituted by large and well-established national and global companies. The brake pads and linings market, which exceeds $6 billion, includes companies such as Nisshinbo, Honeywell, Akebono and Federal Mogul. Key competitive drivers within the OE pad business include technical expertise, formulation development capabilities, scale production, product performance, high-quality standards, customer intimacy and reputation. OEM customers usually require long-lasting and well-established relationships, based on mutual trust, local proximity and a wide range of cooperative activities, starting from the design to the sampling, prototyping and testing phases of brake pads. Within the AM pads market, Motion Technologies is a leading European provider in a highly fragmented global market.

Competitive drivers in the rail damping systems business include price, technical expertise and product performance. Rail damping systems are considered critical components because of safety requirements and thus they have to be specifically designed according to many different train applications, and must satisfy strict compliance requirements. We estimate the rail damping systems and bus dampers segments have a combined available market of approximately $500. Motion Technologies is a global leader in the rail dampers component of the complete rail damper system.

Interconnect Solutions

Headquartered in Santa Ana, California, ICS designs and manufactures a broad range of highly engineered connectors and cable assemblies for critical applications in harsh environments that make it possible to transfer signal and power in an increasingly connected world. Through our brands that include Cannon, VEAM and BIW, this segment serves customers in the aerospace, oil and gas, medical, handheld electronics, industrial, alternative energy, transportation and defense markets. The connectors market is large and fragmented but ICS is generally one of the leading companies in our served markets due to our technology, strong customer relationships, cost performance and global footprint. ICS has seven production facilities, including two in the United States, and one in Mexico, Italy, Germany, England, and China that provide geographic proximity to our key global customers.

Our products and solutions are generally focused in various applications, characterized as harsh environments or telecom, computer and consumer connectors.

- *Harsh Environment Connectors*
  We design, manufacture and sell high performance, military-specification, and commercial electrical connectors of the following types: Circular, Rectangular, Radio Frequency, Fiber Optic, D-sub Miniature, Micro-Miniature and cable assemblies. Based on our technological capabilities in filtering, sealing, contact geometry, composite materials and plating, we focus on product solutions for harsh operating environments. These products are used in aerospace, oil & gas, industrial, defense and transportation markets. Applications include avionics equipment, civil aircraft, industrial automation and production equipment, electric vehicles, medical imaging and diagnostics equipments, rail, construction and agriculture equipment, military equipment, navigation devices and smart phones.

- *Telecom, Computer, Consumer Connectors*
  We design, manufacture and sell high-bandwidth, high density connectors that are used in entertainment equipment, lighting, telecom transmission and switching equipment, cellular base stations, cable and satellite set-top boxes and high end servers. Applications include broadcasting equipment, stage lighting, voice and VoIP telecom equipment, computer workstations, and cellular towers.

ICS products are used in a wide variety of applications throughout the world. ICS sells its products to over 2,500 customers and the four largest customers represent approximately 8% of net sales for the year ended December 31, 2011. ICS's products are sold directly to OEM's, Contract Manufacturers and cable system operators and through its global distribution channel. ICS has a global distribution network and is engaged with the leading distribution companies throughout the world. Many of these distributors have been distributing ICS products for over 70 years. ICS's sales to distributors account for approximately 32% of 2011 sales. ICS also provides custom products for unique applications using its engineering expertise to solve difficult connectivity problems and reliability challenges.

The global market for connectors and related products is estimated to be in excess of $48 billion in 2011. ICS competes with a large number of competitors in a fragmented market. Based on our technological capabilities, we focus mostly on product solutions for harsh operating environments and estimate our addressable market to be approximately $6 billion in 2011. The major competitors for these products are Amphenol, Deutsch, Souriau (Esterline) and Glenair. ICS is one of the leading companies in our served market driven by our technology, our customer relationships, cost performance and global footprint. Our major customers consist of major aerospace and defense companies, as well as other handheld electronics and industrial companies.

Control Technologies

Control Technologies, headquartered in Valencia, California, specializes in highly engineered aerospace components and industrial products. We offer an extensive portfolio of qualified products such as fuel management, actuation and noise absorption components in the aerospace market and a range of products that manage motion and absorb energy in a variety of industrial markets. Our application expertise allows us to offer customized solutions using modular platforms that effectively deliver our technologies into various customer applications. We have strong aftermarket opportunities, particularly in our aerospace business, and a broad customer base with no single customer accounting for more than 10% of Control Technologies revenue.

CT Aerospace

CT Aerospace designs and manufactures flow control and actuation components, motion control, energy absorption and vibration isolation products primarily for commercial aerospace, military and other markets. We estimate the served addressable market for CT Aerospace is approximately $2.4 billion worldwide. Our aircraft component products consist of fuel and water pumps, valves, electro-mechanical rotary and linear actuators, and pressure, temperature, limit, and flow switches for various aircraft systems. Our aircraft interior products include stowage bin rate controls, rotary hinge dampers and actuators, seat recline locks and control cables and a variety of engineered elastomer aircraft interior isolators to protect equipment and keep the interior of the aircraft quiet. We also provide electromechanical seat actuation systems for premium seating products. Military products generally include energy absorption applications. Most of our products are sold direct to the customer by our in-house sales force. We utilize a small third-party business for government spare parts distribution, thereby eliminating extensive administrative costs. CT Aerospace also has a well-established Federal Aviation Agency (FAA) certified repair station which focuses on the aftermarket. The repair station also carries ISO9001/AS9100 and European Aviation Safety Agency (EASA) accreditations.

Our products are custom designed for specific customer applications. We have a highly skilled engineering group for R&D, application engineering and qualification. We conduct fundamental research internally, with universities, and with our customers. We leverage our technical capability to provide innovative and reliable solutions for our customers. Our flow control and actuation products deliver reliability requirements through a unique patented shunt disc technology for pressure and temperature switch applications for hostile environments. In addition, our actuator utilizes a patented optical technology for enhanced reliability. Our pumps have the ability to run dry for extended periods, eliminating potential fire ignition sources in fuel system applications and provide high reliability. Our energy absorption products use patented technology to provide innovative solutions, such as self compensation for load variations. Our noise/vibration isolation products use patented innovations to improve noise control, reduce weight, and reduce installation time.

CT Aerospace sells a wide range of products to the aerospace industry and has many customers globally. Our customers are predominantly commercial airframe manufacturers, airframe systems manufacturers, interior systems, seat manufacturers, commercial airlines and defense contractors. We have strong positions with the leading commercial airframe and systems manufacturers such as Boeing, Parker, Eaton and Honeywell. We have significant content in a number of large commercial transport platforms. We also have significant content on regional and business aircrafts. These platforms provide a long life cycle of original equipment and aftermarket sales.

We serve the aircraft interior market for overhead bins and seating components. The seat actuation market typically sells over 60% of annual sales to modernize existing commercial aircraft fleets. Our business is neither dependent on one or a small number of customers.

In the highly regulated Aerospace Market we benefit from our large installed base of products. We compete by offering a wide portfolio of reliable products, coupled with advanced application expertise and customer support. We believe application expertise and our reputation for quality significantly enhance our market position. Our ability to collaborate with our customers to deliver wide product offerings has allowed us to compete effectively, to cultivate and maintain customer relationships, and to expand into many new markets.

Competitors range from large multi-national corporations to small privately held firms. Our markets are often fragmented and thus there are several types of companies who choose to play in the field. Aviation competitors include Circo, Hydra Electric, Eaton, Lord Corporation, Hutchinson, Ro-RA General Aerospace and Crane. Competition in these markets focuses on application expertise with effective solutions, product delivery and performance, previous installation history, quality, price and customer support. We have been successful in establishing long-term supply agreements with a number of our larger customers, thereby increasing opportunities to win future business.

Given the highly fragmented nature of the Aerospace Repair & Overhaul industry, CT Aerospace competes with a large number of Maintenance Repair and Overhaul (MRO) businesses. Some airlines have established repair and overhaul capabilities which makes them competitors as well. We compete in the repair and overhaul segment of our business by offering a high quality service with increased reliability, coupled with advanced technical expertise.

CT Industrial

CT Industrial designs and manufactures energy absorption, motion control, and general industrial products primarily for the heavy industrial, medical, automation, energy, and shape cutting markets. We estimate the served addressable market for CT Industrial is approximately $4.3 billion globally. Our energy absorption products consist of customized shocks, dampers, and wire rope. CT Industrial possesses a specialized set of skills and capabilities in the energy absorption business. Our motion control products consist of servomotors, actuators, and controllers. Our general industrial products include gas regulators, pressure switches, and web tensioning equipment. We also provide the controls, torches, power supply, and torch tip consumables for the plasma shape cutting industry.

CT Industrial has solid positions in China, Europe, and North America. It has a broad customer base including end users, OEM's, and distribution. Channels to market include direct, commissioned representation and buy-resell distributors. CT Industrial competes by offering a wide portfolio of reliable products that are brought to specific markets as a basket of tools to solve applications for customers. Historically, we have focused on product delivery, quality, performance and application engineering.

Our ability to collaborate with our customers to deliver comprehensive product offerings has allowed us to compete effectively. Two recent examples of this include collaborating with a customer to design a unique solution for under water remote operated vehicles serving off shore oil platforms in our motion control business. Another example includes working with a Chinese customer to develop a unique solution for life extension and efficiency of hydro electric plants in our energy absorption business.

Competitors change depending on the product line and range from large multi-national corporations to small privately held firms. CT Industrial has a leading position in our energy absorption business. Our position in the top three manufacturers in energy absorption is significant in the automation, heavy industrial and energy markets.

The motion control and general industrial businesses are highly fragmented and we compete with a group of industry participants. The main competitor in the servo motor product line is Danaher. Parker is a leading competitor in the pneumatic actuation. This is a diverse, global market. The shape cutting markets are led by Hypertherm, followed by Kjellberg and Thermal Dynamics.

CT Industrial will continue to focus on delivery lead times, quality and performance while enhancing our already strong application engineering offering. The development of new customer service strategies will create a differentiated service offering and improve turnaround time in product, quotations and service communications.

Other Company Information

Materials

All of our businesses require various raw materials, the availability and prices of which may fluctuate. The principal raw materials used in manufacturing our products include steel, iron, aluminum, nickel, tin and copper, as well as specialty alloys, including titanium. Materials are purchased in various forms, such as bar, rod and wire stock, pellets, metal powders, shims, springs, fabricated parts including motors, and machined castings.

Our global sourcing initiatives continue to expand and are designed to capitalize on sources in emerging markets and other low-cost sources of purchased goods balanced with efficient coordinated global logistics. Raw materials, supplies and product subassemblies are purchased from third-party suppliers, contract manufacturers, and commodity dealers. For most of our products, we have existing alternate sources of supply, or such materials are readily available. In some instances we depend on a single source of supply, manufacturing or assembly or participate in commodity markets that may be subject to a limited number of suppliers.

We continually monitor the business conditions of our supply chain to maintain our market position and to avoid potential supply disruptions. There have been no raw materials shortages that have had a material adverse impact on our business as a whole, and we have been able to develop a robust supply chain such that we do not anticipate shortages of such materials in the future.

Although some cost increases may be recovered through increased prices to customers, our operating results are generally exposed to such fluctuations. We attempt to control such costs through fixed-priced contracts with suppliers and various other cost containment strategies, such as our GSCS initiative. We typically acquire materials and components through a combination of blanket and scheduled purchase orders to support our materials requirements for an average of four to eight weeks, with the exception of some specialty materials. From time to time, we experience significant price volatility or supply constraints for materials that are not available from multiple sources such as certain rare earth minerals. In limited circumstances, we may have to obtain scarce components for higher prices on the spot market, which may have a negative impact on gross margin and can periodically create a disruption to production and delivery. We also acquire certain inventory in anticipation of supply constraints or enter into longer-term pricing commitments with vendors to improve the priority, price and availability of supply. We evaluate hedging opportunities to mitigate or minimize the risk of operating margin erosion resulting from the volatility of commodity prices.

Manufacturing Methods

We utilize two primary methods of fulfilling demand for products: build-to-order and engineer-to-order. Build-to-order assembly consists of building a group of products with the same pre-defined specifications, generally for our OEM customers' inventory. Engineer-to-order assembly consists of building a customized system for a customer's individual order specifications. In both cases, we offer design, integration, test and other production value-added services. We employ build-to-order capabilities to maximize manufacturing and logistics efficiencies by producing high volumes of basic product configurations. Engineering products to order permits the configuration of units to meet the customized requirements of our customers. Our inventory management and distribution practices in both build-to-order and engineer-to-order seek to minimize inventory holding periods.

Backlog

Delivery schedules vary from customer to customer based on their requirements. For example, large complex projects in specialized markets such as oil and gas and mining at Industrial Process require longer lead times and production cycles. Delivery delays could arise from changes in the customer's requirements or technical difficulties. Total backlog, representing firm orders that have been received, acknowledged and entered into our production systems, was $850 and $682 at December 31, 2011 and 2010, respectively. Total backlog at December 31, 2011 was comprised of 57% from Industrial Process, 19% from Motion Technologies and 12% from each ICS and Control Technologies. We expect to satisfy nearly all December 31, 2011 backlog commitments during 2012.

Intellectual Property

We generally seek patent protection for those inventions and improvements that are likely to be incorporated into our products or where proprietary rights are expected to improve our competitive position. The highly customized application engineering embedded within our products, our proprietary rights and our knowledge capabilities all contribute to enhancing our competitive position.

While we own and control a significant number of patents, trade secrets, confidential information, trademarks, trade names, copyrights, and other intellectual property rights which, in the aggregate, are of material importance to our business, management believes that our business, as a whole, as well as each of our core segments, is not materially dependent on any one intellectual property right or related group of such rights. Patents, patent applications, and license agreements will expire or terminate over time by operation of law, in accordance with their terms or otherwise. As the portfolio of our patents, patent applications, and license agreements has evolved over a long period of time, we do not expect the expiration of any specific patent or other intellectual property right to have a material adverse effect on our financial position, results of operations or cash flows.

Research and Development

R&D is a key element of ITT's engineering culture and is generally focused on the design and development of products and solutions that anticipate customer needs and emerging trends. In addition, our R&D is based on taking technology quickly to the tangible phase, increasing the competitive offering, and increasing the customer service level through application engineered solutions.

Product development efforts at Industrial Process focus on technologies that reduce customer's total cost of ownership. We have significantly expanded our API pump coverage to service the oil & gas market. During 2011, we introduced some key new products, including two slurry valves and a slurry pump to service the mining market and a high pressure ring section pump for reverse osmosis and general industrial applications.

Motion Technologies R&D activities focus on the design and development of products and solutions that either meet specific customers' needs or anticipate new market trends and environmental regulations. During 2011, Motion Technologies introduced key new products, including a low-copper content brake pad, new friction materials for the North American market and the Ceramic product line for high-performance European aftermarket. Additionally, in 2012 Motion Technologies will begin construction of a new R&D and production center in Wuxi, China. The facility, expected to be completed in mid-2012, will be focused on driving development of friction materials suited to performance requirements specific of the Chinese market, to better serve local demands and to be included in all new projects currently restricted to local suppliers.

ICS's R&D programs are focused on bringing products to market that satisfy the present and future needs of the connectors industry. Our product designs attempt to deliver solutions to size reduction and bandwidth expansion challenges, while providing reliable power and signal connections that meet and exceed the requirements of our customers. Our new J1772 Electric Vehicle connector was the first in the industry to receive approval from UL, the electrical safety testing and certification organization, and won product of the year awards in 2011. Our new QLC miniature high density connector, used in medical ultrasound equipment, was selected by a leading medical equipment company as their choice for all new ultrasound equipment.

Control Technologies R&D efforts are aimed at producing innovative technologies that solve our customer's critical issues. During 2011, we introduced Enidamp(tm), a vibration control product that significantly reduces vibrations on commercial aircraft that allows critical overheat detection system to function properly. Other important developments in 2011 were an environmentally friendly shock absorber and an actuator for gate valves that addresses two critical customer concerns. First, it is extremely light in weight, and second, it can meet or exceed customer lead time requirements.

We anticipate our investments in future R&D activities will moderately increase from current spending levels to ensure a continuing flow of innovative, high quality products and maintain our competitive position in the markets we serve. Such activities are conducted in laboratory and engineering facilities at several of our major manufacturing locations, as well as in our dedicated R&D facilities strategically positioned close to our customers. During 2011, 2010 and 2009, we recognized R&D expenses of $66, $61, and $53, respectively, within operating expenses, which is 3.1%, 3.2% and 3.0% as a percent of revenues, respectively.

Cyclicality and Seasonality

Many of the businesses in which we operate are subject to specific industry and general economic cycles. Our connectors business tends to be impacted more in the early portion of an economic cycle, while the automotive and aerospace components businesses tend to expand in the middle portion of the economic cycle and the industrial pump business typically benefits from late cycle expansion.

Our businesses experience limited seasonal variations, with demand generally at an annual low during summer months (our third quarter) mainly attributable to European automotive manufacturing shutdowns and the planned industrial maintenance activities of our customers. Revenue impacts from the limited seasonal variations are typically mitigated by our backlog of orders that allow us to adjust levels of production across the summer months.

Environmental Matters

We are subject to stringent federal, state, local, and foreign environmental laws and regulations concerning air emissions, water discharges and waste disposal. In the United States, these include but are not limited to the Federal Clean Air Act, the Clean Water Act, the Resource, Conservation and Recovery Act, and the Comprehensive Environmental Response, Compensation and Liability Act. Environmental requirements are significant factors affecting our operations. We have established an internal program to assess compliance with applicable environmental requirements for our facilities. The program, which includes periodic audits of many of our locations, including our major operating facilities, is designed to identify problems in a timely manner, correct deficiencies and prevent future noncompliance.

Management does not believe, based on current circumstances, that we will incur compliance costs pursuant to such regulations that will have a material adverse effect on our financial position, results of operations or cash flows. We believe we closely monitor our environmental responsibilities, together with trends in the environmental laws. In addition, we have purchased insurance protection against certain environmental risks arising out of our business. Environmental laws and regulations are subject to change, however, the nature and timing of which may be difficult to predict.

Accruals for environmental liabilities are recorded on a site-by-site basis when it is probable that a liability has been incurred and the amount of the liability can be reasonably estimated, based on current law and existing technologies. Our estimated liability is undiscounted and is reduced to reflect the participation of other potentially responsible parties in those instances where it is probable that such parties are legally responsible and financially capable of paying their respective share of the relevant costs. At December 31, 2011, we had accrued $102 related to environmental matters. Such estimates are subject to change and may be affected by many factors, such as new information about a site, evolving scientific knowledge about risk associated with any contamination involved, developments affecting remediation technology, and attitudes of regulatory authorities.

Employees

As of December 31, 2011, we had approximately 8,500 employees, of which approximately 3,500 were located in the United States. Approximately 15% of our U.S. employees are represented by unions. We also have unionized employees in Italy and Brazil. No one unionized facility accounts for more than 20% of ITT total revenues. Although our relations with our employees are strong and we have not experienced any material strikes or work stoppages recently, no assurances can be made that we will not experience these or other types of conflicts with labor unions, works councils, other groups representing employees or our employees generally, or that any future negotiations with our labor unions will not result in significant increases in our cost of labor. On July 28, 2012, our contract with the United Steelworkers at our Seneca Falls, NY location will expire. Negotiations to renew this contract have not yet begun. This union contract covered 387 employees as of December 31, 2011.

Available Information, Internet Address and Internet Access to Current and Periodic Reports

ITT's website address is www.itt.com. ITT makes available free of charge on or through www.itt.com/ir our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and all amendments to those reports as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities and Exchange Commission (SEC). Information contained on our website is not incorporated by reference unless specifically stated herein. As noted, we file the above reports electronically with the SEC, and they are available on the SEC's web site (www.sec.gov). In addition, all reports filed by ITT with the SEC may be read and copied at the SEC's Public Reference Room located at 100 F Street, N.E., Room 1580, Washington, D.C. 20549. Information on the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330.

ITEM 1A. RISK FACTORS

We are subject to a wide range of factors that could materially affect future developments and performance. Because of these factors, past performance may not be a reliable indicator of future results. Set forth below and elsewhere in this document are descriptions of the risks and uncertainties that could cause our actual results to differ materially from the results contemplated by the forward-looking statements contained in this document. The most significant factors affecting our business and operations include the following:

Business and Operating Risks

Our exposure to pending and future asbestos claims and related assets, liabilities, and cash flows are subject to significant uncertainties, which could have adverse effects on our financial position, results of operations and cash flows.

ITT, including its subsidiary Goulds Pumps, Inc., has been joined as a defendant in numerous lawsuits and claims in which the plaintiffs claim damages for personal injury arising from exposure to asbestos in connection with certain products sold or distributed that may have contained asbestos. We expect to be named as defendants in similar actions in the future. We record an estimated liability related to pending claims and claims estimated to be received over the next ten years based on a number of key assumptions, including the plaintiffs' propensity to sue, claim acceptance rates, disease type, settlement values and defense costs. These assumptions are derived from ITT's recent experience and reflect the Company's expectations about future claim activities. These assumptions about the future may or may not prove accurate, and accordingly, the Company may incur additional liabilities in the future. A change in one or more of the inputs used to estimate the asbestos liability could materially change the estimated liability and associated cash flows for pending claims and those estimated to be filed in the next 10 years. Although it is probable that the Company will incur additional costs for asbestos claims filed beyond the next 10 years, we do not believe there is a reasonable basis for estimating those costs at this time.

We record an asset that represents our best estimate of probable recoveries from insurers or other responsible parties for the estimated asbestos liabilities. There are significant assumptions made in developing estimates of asbestos-related recoveries, such as policy triggers, policy or contract interpretation, the methodology for allocating claims to policies, and the continued solvency of the Company's insurers or other responsible parties. Certain of our primary coverage in place agreements are expected to exhaust in the next twelve months, which may result in higher net cash outflows for the short-term. The assumptions underlying the recorded asset may not prove accurate, and as such, actual performance by our insurers and other responsible parties could result in lower receivables or cash flows expected to reduce the Company's asbestos costs.

Due to these uncertainties, as well as our inability to reasonably estimate any additional asbestos liability for claims that may be filed beyond the next 10 years, it is not possible to predict the ultimate outcome of the cost, nor potential recoveries, of resolving the pending and all unasserted asbestos claims. Additionally, we believe it is possible that the cost of asbestos claims filed beyond the next 10 years, net of expected recoveries, could have a material adverse effect on our financial position, results of operations and cash flows.

Many uncertainties exist surrounding asbestos litigation, and the Company will continue to evaluate its estimated asbestos-related liability and corresponding estimated insurance reimbursement as well as the underlying assumptions and process used to derive these amounts. Changes in estimates related to these uncertainties may result in increases or decreases to the net asbestos liability, particularly if the quality or number of claims or settlement or defense costs change significantly, or if there are significant developments in the trend of case law or court procedures, or if legislation or another alternative solution is implemented; however, the Company is currently unable to estimate such future changes. Although the resolution of asbestos claims takes many years, the effect of changes in our estimates related to our pending or estimated future claims in any given period could be material to our results of operations, financial position and cash flow.

In addition, as part of the Distribution, ITT indemnified Exelis and Xylem with respect to asserted and unasserted asbestos claims that relate to the presence or alleged presence of asbestos in products manufactured, repaired or sold prior to the Distribution Date, subject to limited exceptions.

Our operating results and our ability to maintain liquidity or procure capital may be adversely affected by unfavorable economic and capital market conditions and the uncertain geopolitical environment.

We have experienced and expect to continue to experience fluctuations in revenues and operating results due to economic and business cycles. Our international operations, including sales of U.S. exports, comprise a growing portion of our operations and are a strategic focus for continued future growth. Our strategy calls for increasing sales to operations in overseas markets, including developing markets such as Central and South America, China, India and the Middle East. In 2011, approximately 63% of our total sales were to customers operating outside of the United States.

Important factors impacting our businesses include the overall strength of these economies and our customers' confidence in both local and global macro economic conditions, industrial spending, interest rates, availability of commercial financing for our customers and end-users and unemployment rates. A slowdown or downturn in these financial or macro economic conditions could have a significant adverse effect on our business, financial position, results of operations and cash flow.

We may be adversely affected by disruptions in financial markets or downturns in economic activity in specific countries or regions, or in the various industries in which the Company operates or be subject to adverse changes in the availability and cost of capital, interest rates, tax rates, or regulations in the jurisdictions in which the Company operates. Many of the industries in which we operate are subject to specific industry and general economic cycles. We serve a diverse mix of customers in global infrastructure industries which can be volatile. The industries on which our business is most reliant include oil & gas, energy & mining, automotive, truck, trailer and public bus and rail transportation, aerospace and defense, electronics, and related industrial markets each of which are impacted.

Instability in the global credit markets, including the recent European economic and financial turmoil related to sovereign debt issues in certain countries and the instability in the geopolitical environment in many parts of the world, may continue to put pressure on global economic conditions. The world has recently experienced a global macroeconomic downturn, and if global economic and market conditions, or economic conditions in key markets, remain uncertain or deteriorate further, we may experience material impacts on our business, financial position, results of operations and cash flow. If, for any reason, we lose access to our currently available lines of credit, or if we are required to raise additional capital, we may be unable to do so or we may be able to do so only on unfavorable terms.

Adverse changes to financial conditions could jeopardize certain counterparty obligations, including those of our insurers and customers. We closely monitor the credit worthiness of our insurers and customers and evaluate their ability to service their obligations to us. The tightening of credit markets may reduce funds available to our customers to pay for or buy our products and services for an unknown, but perhaps lengthy, period. As it relates to our customers' ability to pay for products and services, we have not experienced any significant negative consequences as a result of the recent economic downturn.

Should market conditions deteriorate, it may result in the delay or cancellation of orders from our customers or potential customers and adversely affect our revenues and our ability to collect insurer and customer receivables, manage inventory levels, and maintain current levels of profitability. Restrictive credit markets may also result in customers extending terms for payment and may result in our having higher customer receivables with increased default rates.

Economic and other risks associated with international sales and operations could adversely affect our business.

Both our sales from international operations and export sales are subject in varying degrees to risks inherent to doing business outside the United States. These risks include the following:

- Possibility of unfavorable circumstances arising from host country laws or regulations;
- Currency exchange rate fluctuations and restrictions on currency repatriation;
- Potential negative consequences from changes to taxation policies;
- The disruption of operations from labor and political disturbances;
- Our ability to hire and maintain qualified staff in these regions; and
- Changes in tariff and trade barriers and import and export licensing requirements.

The cost of compliance with increasingly complex and often conflicting regulations worldwide can also impair our flexibility in modifying product, marketing, pricing, or other strategies for growing our businesses, as well as our ability to improve productivity and maintain acceptable operating margins.

In addition to the general risks that we face outside the United States, we now conduct more of our operations in emerging markets than we have in the past, which could involve additional uncertainties for us, including risks that governments may impose limitations on our ability to repatriate funds; governments may impose withholding or other taxes on remittances and other payments to us, or the amount of any such taxes may increase; governments may seek to nationalize our assets; or governments may impose or increase investment barriers or other restrictions affecting our business. In addition, emerging markets pose other uncertainties, including the protection of our intellectual property, pressure on the pricing of our products, and risks of political instability.

A substantial portion of our cash is generated by our foreign subsidiaries and repatriation of that cash to the United States may be inefficient from a tax perspective. Any payment of distributions, loans or advances to us by our foreign subsidiaries could be subject to restrictions on, or taxation of, dividends on repatriation of earnings under applicable local law, monetary transfer restrictions and foreign currency exchange regulations in the jurisdictions in which our subsidiaries operate.

We are exposed to fluctuations in foreign currency exchange rates, particularly with respect to the Euro, Czech Kurona, Chinese Renminbi, South Korean Won, Mexican Peso, British Pound, Brazilian Real, Australian Dollar and Canadian Dollar. As we continue to grow our business internationally, our operating results could be affected by the relative strength of the European, Asian and developing economies and the impact of currency exchange rate fluctuations. Any significant change in the value of currencies of the countries in which we do business relative to the value of the U.S. Dollar could affect our ability to sell products competitively and control our cost structure, which could have a material adverse effect on our business, financial position, results of operations and cash flow.

Failure to compete successfully in our markets could adversely affect our business.

We provide products and services into competitive markets. We believe the principal points of competition in our markets are product performance, reliability and innovation, application expertise, brand reputation, energy efficiency, product life cycle cost, timeliness of delivery, proximity of service centers, effectiveness of our distribution channels and price.

Maintaining and improving our competitive position will require continued investment by us in manufacturing, research and development, engineering, marketing, customer service and support, and our distribution networks. We may not be successful in maintaining our competitive position. Our competitors may develop products that are superior to our products, or may develop more efficient or effective methods of providing products and services or may adapt more quickly than we do to new technologies or evolving customer requirements. Pricing pressures also could cause us to adjust the prices of certain products to stay competitive. We may not be able to compete successfully with existing or new competitors.

Our operating costs are subject to fluctuations, particularly due to changes in commodity prices, raw materials, energy and related utilities, freight, and cost of labor. In order to remain competitive, we may not be able to recuperate all or a portion of these higher costs from our customers through product price increases. Further, our ability to realize financial benefits from Six Sigma and Lean projects may not be able to mitigate fully or in part these manufacturing and operating cost increases and, as a result, could negatively impact our profitability.

If we fail to manage the distribution of our products and services properly, our revenue, gross margin and profitability could suffer.

We use a variety of distribution methods to sell our products and services, including third-party distributors and resellers. Successfully managing the interaction of our distributors and resellers is a complex process as we sell a broad mix of products through a network of over 500 distributors and resellers. Moreover, since each distribution method has distinct risks and gross margins, our failure to implement the most advantageous balance in the delivery model for our products and services could adversely affect our revenue and gross margins and therefore our profitability.

Our financial results could be materially adversely affected due to the loss of a distributor, channel conflicts or if the financial conditions of our channel partners were to weaken. Our future operating results may be adversely affected by any conflicts that might arise between our various sales channels, the loss or deterioration of any distribution or reseller arrangement. In particular, one distributor accounts for approximately 31% of Motion Technologies revenues and approximately 9% of consolidated ITT revenue. Our contract with this distributor consists of several subcontracts which are scheduled to expire at various times between 2014 and 2018. Moreover, some of our distributors may have insufficient financial resources and may not be able to withstand changes in business conditions, including economic weakness. Considerable trade receivables are outstanding with our distribution partners. Revenue from indirect sales could suffer, and we could experience disruptions in distribution if our distributors' financial conditions, abilities to borrow funds in the credit markets or operations weaken.

Further, we must manage inventory effectively, particularly with respect to sales to distributors, which involves forecasting demand and potential pricing issues. Distributors may increase orders during periods of product shortages, cancel orders if their inventory is too high or delay orders in anticipation of new products. Distributors also may adjust their orders in response to the supply of our products and the products of our competitors and seasonal fluctuations in end-user demand. Our reliance on indirect distribution methods may reduce visibility to demand and potential pricing issues, and therefore make forecasting more difficult. If we have excess or obsolete inventory, we may have to reduce our prices and write down inventory. Moreover, our use of indirect distribution channels may limit our willingness or ability to adjust prices quickly and otherwise to respond to pricing changes by competitors.

Our business could be adversely affected by raw material price volatility and the inability of key suppliers to meet quality and delivery requirements.

Our business relies on third-party suppliers for raw materials, components, and contract manufacturing services to produce our products. The supply of raw materials to the Company and to its component parts suppliers and the supply of castings, motors, and other critical components could be interrupted for a variety of reasons, including availability and pricing. Prices for raw materials necessary for production have fluctuated significantly in the past and significant increases could adversely affect the Company's results of operations and profit margins. Due to pricing pressure or other factors, the Company may not be able to pass along increased raw material and components parts prices to its customers in the form of price increases or its ability to do so could be delayed. Consequently, its results of operations and financial condition may be adversely affected.

For most of our products, we have existing alternate sources of supply, or such materials are readily available. In some instances we depend on a single source of supply, manufacturing or assembly or participate in commodity markets that may be subject to a limited number of suppliers. Delays in obtaining supplies may result from a number of factors affecting our suppliers, including production interruptions at suppliers, capacity constraints, labor disputes, the impaired financial condition of a particular supplier, the ability of suppliers to meet regulatory requirements, and suppliers' allocations to other purchasers. Any delay in our suppliers' abilities to provide us with sufficient quality and flow of materials, price increases, or decreased availability of raw materials or commodities could impair our ability to deliver products to our customers and, accordingly, could have an adverse effect on our business, results of operations and financial position.

Changes in our effective tax rates as a result of changes in the geographic earnings mix, tax examinations or disputes, tax authority rulings, or changes in the tax laws applicable to us may adversely affect our financial results.

The Company is subject to income taxes in the United States and in various foreign jurisdictions. We exercise significant judgment in calculating our provision for income taxes and other tax liabilities. In the ordinary course of our business, there are many transactions and calculations where the ultimate tax determination is uncertain. Furthermore, changes in domestic or foreign income tax laws and regulations, or their interpretation, could result in higher or lower income tax rates assessed or changes in the taxability of certain sales or the deductibility of certain expenses, thereby affecting our income tax expense and profitability.

Given the global nature of our business, a number of factors may increase our future effective tax rates, including:

- Decisions to repatriate non-U.S. earnings for which we have not previously provided for U.S. income taxes;
- Changes in the geographic mix of our profits among jurisdictions with differing statutory income tax rates;
- Sustainability of historical income tax rates in the jurisdictions in which we conduct business;
- Changes in tax laws applicable to us;
- The resolution of issues arising from tax audits with various tax authorities; and
- Changes in the valuation of our deferred tax assets and liabilities, and changes in deferred tax valuation allowances.

The amount of income taxes and other taxes are subject to ongoing audits by U.S. federal, state and local tax authorities and by non-U.S. authorities. If these audits result in assessments different from amounts recorded, future financial results may include unfavorable tax adjustments. We are currently under examination by the U.S. Internal Revenue Service and other tax authorities, and we may be subject to additional examinations in the future. The tax authorities may disagree with our tax treatment of certain material items and thereby increase our tax liability. Failure to sustain our position in these matters could result in a material and adverse effect on our cash flow and financial position.

Any significant increase in our future effective tax rates could reduce net income for future periods.

The level of returns on postretirement benefit plan assets, changes in interest rates and other factors could affect our earnings and cash flows in future periods.

A portion of our current and retired employee population is covered by pension and other employee-related defined benefit plans (collectively, postretirement benefit plans). We may experience significant fluctuations in costs related to postretirement benefit plans as a result of macroeconomic factors, such as interest rates, that are beyond our control. The cost of our postretirement plans is incurred over long periods of time and involves various factors and uncertainties during those periods, which can be volatile and unpredictable, including the rates of return on postretirement benefit plan assets, discount rates used to calculate liabilities and expenses, and trends for future medical costs. Management develops each assumption using relevant Company experience in conjunction with market-related data. Our liquidity, financial position, including shareholders' equity, and results of operations could be materially affected by significant changes in key economic indicators, financial market volatility, future legislation and other governmental regulatory actions.

We make contributions to fund our postretirement benefit plans when considered necessary or advantageous to do so. The macro-economic factors discussed above, including the return on postretirement benefit plan assets and the minimum funding requirements established by local government funding or taxing authorities, or established by other agreement, may influence future funding requirements. A significant decline in the fair value of our plan assets, or other adverse changes to our overall pension and other employee-related benefit plans could require increased funding contributions and could affect cash flows in future periods.

We rely on our information systems in our operations. Security breaches could adversely affect our business and results of operations. Our information system structure could make it more difficult to cost-effectively implement changes.

The efficient operation of our business is dependent on computer hardware and software systems. Even the most well-protected information systems are vulnerable to internal and external security breaches including those by computer hackers and cyber terrorists. The unavailability of our information systems, the failure of these systems to perform as anticipated for any reason or any significant breach of security could disrupt our business and could result in decreased performance and increased overhead costs, causing an adverse effect on our business, and the consolidated results of operations or financial position.

Our information systems infrastructure is centralized, but our information system applications are both centralized and decentralized. The centralized infrastructure presents a risk in that a potential security breach could have a company-wide impact. The decentralized applications could result in significant replacement costs were the company to decide to replace a number of the independent operating systems or consolidate operating systems. The inter-relationship of information systems also presents an additional risk when upgrading or replacing information systems.

Risk Relating to the Distribution

Following the Distribution, we are a smaller, more focused company and may be more susceptible to market fluctuations, increased costs and less favorable purchasing terms.

As a larger company prior to the Distribution we were able to enjoy certain benefits from operating diversity and purchasing leverage. Following the Distribution, we are a smaller company and as a result there is a risk that we may be more susceptible to market fluctuations and other adverse events than we would have otherwise been if we were still a part of a larger and more operationally diverse company. We may also experience increased costs and less favorable terms as a result of our inability to continue to leverage the purchasing spend of our former businesses. Prior to the Distribution we negotiated favorable pricing terms with many of our suppliers, some of which have volume-based pricing. In the future, as we establish new pricing terms, our reduced volume demand could negatively impact future pricing from suppliers. All of these outcomes may result in our products being more costly to manufacture and less competitive. Although we cannot predict the extent of any such increased costs, it is possible that such costs could have a negative impact on our business and results of operations.

In connection with the Distribution, Exelis and Xylem indemnified us for certain liabilities and we indemnified Exelis and Xylem for certain liabilities. This indemnity may not be sufficient to insure us against the full amount of the liabilities assumed by each of Exelis and Xylem and each of Exelis and Xylem may be unable to satisfy its indemnification obligations to us in the future.

As part of the Distribution Agreement, ITT, Exelis, and Xylem indemnified each other with respect to such parties' assumed or retained liabilities pursuant to the Distribution Agreement and breaches of the Distribution Agreement or related spin agreements. There can be no assurance that the indemnity from Exelis and Xylem will be sufficient to protect us against the full amount of these and other liabilities, or that each of Exelis and Xylem will be able to fully satisfy its indemnification obligations. Third-parties could also seek to hold us responsible for any of the liabilities that each of Exelis and Xylem has agreed to assume. Even if we ultimately succeed in recovering from Exelis and Xylem any amounts for which we are held liable, we may be temporarily required to bear these losses ourselves. In addition, performance on indemnities that we provided Exelis and Xylem may be significant and could negatively impact our business. Each of these risks could negatively affect our business, results of operations and financial position.

We may be responsible for U.S. Federal income tax liabilities that relate to the Distribution.

In connection with the Distribution, we received an U.S. Internal Revenue Service (IRS) Ruling stating that ITT and its shareholders will not recognize any taxable income, gain, or loss for U.S. Federal income tax purposes as a result of the Distribution. The IRS Ruling, while generally binding upon the IRS, is based on certain factual statements and representations. If any such factual statements or representations were incomplete or untrue in any material respect, or if the facts on which the IRS Ruling was based are materially different from the facts at the time of the Distribution, the IRS could modify or revoke the IRS Ruling retroactively.

Certain requirements for tax-free treatment that are not covered in the IRS Ruling are addressed in an opinion of counsel delivered in connection with the Distribution. An opinion of counsel is not binding on the IRS. Accordingly, the IRS may reach conclusions with respect to the Distribution that are different from the conclusions reached in the opinion. Like the IRS Ruling, the opinion is based on certain factual statements and representations, which, if incomplete or untrue in any material respect, could alter counsel's conclusions.

If all or a portion of the Distribution does not qualify as a tax-free transaction because any of the factual statements or representations in the IRS Ruling or the legal opinion are incomplete or untrue, or because the facts upon which the IRS Ruling is based are materially different from the facts at the time of the Distribution, ITT would recognize a substantial gain for U.S. Federal income tax purposes. In such case, under U.S. Treasury regulations, each member of the ITT consolidated group at the time of the Distribution would be severally liable for the resulting entire amount of any U.S. Federal income tax liability.

Even if the Distribution otherwise qualifies as a tax-free transaction for U.S. Federal income tax purposes, the Distribution will be taxable to ITT (but not to ITT shareholders) pursuant to Section 355(e) of the Internal Revenue Code if there are one or more acquisitions (including issuances) of the stock of ITT, Exelis Inc. or Xylem Inc., representing 50% or more, measured by vote or value, of the then-outstanding stock of any such corporation, and the acquisition or acquisitions are deemed to be part of a plan or series of related transactions that include the Distribution. Any acquisition of ITT, Exelis Inc. or Xylem Inc. common stock within two years before or after the Distribution (with exceptions, including public trading by less-than-5% shareholders and certain compensatory stock issuances) generally will be presumed to be part of such a plan unless that presumption is rebutted. The tax liability resulting from the application of Section 355(e) would be substantial. In addition, under U.S. Treasury regulations, each member of the ITT consolidated group at the time of the Distribution would be severally liable for the resulting U.S. Federal income tax liability.

Each of Exelis and Xylem has agreed not to enter into any transaction that could cause any portion of the Distribution to be taxable to ITT, including under Section 355(e). Pursuant to the Tax Matters Agreement entered into in connection with the Distribution, ITT, Exelis and Xylem have agreed to indemnify each other for any tax liabilities resulting from such transactions, and ITT, Exelis and Xylem have agreed to indemnify each other for any tax liabilities resulting from such transactions entered into by them. These obligations may discourage, delay or prevent a change of control of our company.

The Distribution may expose us to potential liabilities arising out of state and federal fraudulent conveyance laws and legal distribution requirements.

While unlikely, the Distribution could also be challenged under state corporate distribution statutes. Under the Indiana Business Corporation Law, a corporation may not make distributions to its shareholders if, after giving effect to the distribution, (i) the corporation would not be able to pay its debts as they become due in the usual course of business; or (ii) the corporation's total assets would be less than the sum of its total liabilities. No assurance can be given that a court will not later determine that the distribution of our shares in connection with the Distribution was unlawful.

No assurance can be given as to what standard a court would apply to determine insolvency or that a court would determine that we were solvent at the time of or after giving effect to the Distribution.

Under the Distribution Agreement, from and after the Distribution, we will be responsible for the debts, liabilities and other obligations related to the business or businesses which we own and operate following the consummation of the Distribution. Although we do not expect to be liable for any of these or other obligations not expressly assumed by us pursuant to the Distribution Agreement, it is possible that we could be required to assume responsibility for certain obligations retained by Exelis or Xylem should Exelis or Xylem fail to pay or perform its retained obligations. In addition, we will be subject to additional liability if we are unsuccessful in defending the complaint brought by the Ad Hoc Committee of Bondholders alleging breach of the early redemption provisions of bonds issued in 2009.

Other Risks, Including Litigation and Regulatory Risk

Long-lived assets, including goodwill and other intangible assets, represent a significant portion of our assets and any impairment of these assets could negatively impact our results of operations.

At December 31, 2011, our long-lived assets, representing fixed assets, goodwill and other intangible assets, were approximately $922, net of accumulated amortization, which represented approximately 25% of our total assets. Goodwill and indefinite-lived intangible assets are tested for impairment on an annual basis, or whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. We also review the carrying value of finite-lived tangible and intangible assets for impairment when impairment indicators arise. We estimate the fair value of reporting units used in the goodwill impairment test and indefinite-lived intangible assets using an income approach, and as a result the fair value measurements depend on revenue growth rates, future operating margin assumptions, risk-adjusted discount rates, assumed royalty rates, future economic and market conditions, and identification of appropriate market comparable data. Because of the significance of our long-lived assets, including goodwill and other intangible assets, any future impairment of these assets could have a material adverse effect on our results of operations and financial position.

We are subject to laws, regulations and potential liability relating to claims, complaints and proceedings, including those related to product and other matters.

We are subject to various laws, ordinances, regulations and other requirements of government authorities in the United States and in foreign countries, any violations or failure to comply with securities laws, trade or tax rules or similar regulations could create a substantial liability for us, and also could cause harm to our reputation. Changes in laws, ordinances, regulations or other government policies, the nature, timing, and effect of which are uncertain, may significantly increase our expenses and liabilities.

From time to time we are involved in legal proceedings that are incidental to the operation of our businesses. Some of these proceedings allege damages relating to product liability, personal injury claims, employment and pension matters and commercial or contractual disputes, sometimes related to acquisitions or divestitures. Additionally, we may become subject to significant claims of which we are currently unaware or the claims of which we are aware may result in our incurring a significantly greater liability than we anticipate or can estimate.

Changes in environmental laws or regulations, the discovery of previously unknown or more extensive contamination, or the failure of a potentially responsible party to perform may adversely affect our financial results.

We could be affected by changes in environmental laws or regulations, including, for example, those imposed in response to vapor intrusion or climate change concerns.

Environmental laws and regulations allow for the assessment of substantial fines and criminal sanctions as well as facility shutdowns to address violations, and may require the installation of costly pollution control equipment or operational changes to limit emissions or discharges.

Developments such as the adoption of new environmental laws and regulations, violations by us of such laws and regulations, discovery of previously unknown or more extensive contamination, litigation involving environmental impacts, our inability to recover costs associated with any such developments, or financial insolvency of other potentially responsible parties could have a material adverse effect on our financial position, results of operations, or cash flows.

Failure to comply with the U.S. Foreign Corrupt Practices Act or other applicable anti-corruption legislation could result in fines, criminal penalties and an adverse effect on our business.

We operate in a number of countries throughout the world, including countries known to have a reputation for corruption. We are committed to doing business in accordance with applicable anti-corruption laws. We are subject, however, to the risk that we, our affiliated entities or our or their respective officers, directors, employees and agents may take action determined to be in violation of such anti-corruption laws, including the U.S. Foreign Corrupt Practices Act of 1977 and the U.K. Bribery Act of 2010, as well as trade sanctions administered by the Office of Foreign Assets Control, or OFAC, and the U.S. Department of Commerce. Any such violation could result in substantial fines, sanctions, civil and/or criminal penalties, curtailment of operations in certain jurisdictions, and might adversely affect our business, results of operations or financial positions. In addition, actual or alleged violations could damage our reputation and ability to do business. Furthermore, detecting, investigating, and resolving actual or alleged violations is expensive and can consume significant time and attention of our senior management.

Anti-takeover provisions in our organizational documents and Indiana law could delay or prevent a change in control.

Certain provisions of our articles of incorporation and by-laws may delay or prevent a merger or acquisition that a shareholder may consider favorable. For example, the articles of incorporation and by-laws, among other things, provide for advance notice for shareholder proposals and nominations and do not permit action by written consent of the shareholders. In addition, the articles of incorporation authorize our Board of Directors to issue one or more series of preferred stock. These provisions may also discourage acquisition proposals or delay or prevent a change in control, which could harm our stock price. Indiana law also imposes some restrictions on mergers and other business combinations between any holder of 10% or more of our outstanding common stock and us as well as certain restrictions on the voting rights of "control shares" of an "issuing public corporation."

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

We have 132 locations, in 31 countries. These properties total 6.5 million square feet, of which 102 locations, or 3.0 million square feet are leased. We consider the offices, plants, warehouses, and other properties that we own or lease to be in good condition and generally suitable for their intended purpose, are adequate for the Company's needs and will allow for expansion of capacity if needed. The following table details our quantitatively or qualitatively significant locations by segment.

LOCATION	SQ FT (IN '000S)	OWNED / LEASED
Industrial Process		
Seneca Falls, New York	828	Owned
Amory, Mississippi	110	Leased
Lancaster, Pennsylvania	89	Owned
City of Industry, California	74	Owned
Southaven, Mississippi	69	Leased
Salto, Brazil	68	Owned
Baroda, India	60	Leased
Tizayuca, Mexico	47	Owned
Axminster, United Kingdom	45	Leased
Cheongwon, South Korea	39	Owned
Shanghai, China	35	Leased
Perth, Australia	28	Leased
Dammam, Saudi Arabia	27	Leased
Motion Technologies		
Oud Beijerland, Netherlands	379	Owned
Barge, Italy	279	Owned
Ostrava, Czech Republic	256	Leased
Vauda Canavese, Italy	97	Owned
Contrada Pantano, Italy	94	Owned
Hebron, Kentucky	42	Leased
Kelsterbach, Germany	28	Leased
Interconnect Solutions		
Santa Ana, California	364	Owned
Nogales, Mexico	300	Owned
Weinstadt, Germany	231	Owned
Shenzhen, China	227	Leased
Basingstoke, England	179	Leased
Lainate, Italy	53	Leased
Control Technologies		
Valencia, California	200	Leased
Wuxi, China	167	Leased
Orchard Park, New York	92	Owned
Westminster, South Carolina	66	Owned
Ladson, South Carolina	42	Owned
Billerica, Massachusetts	24	Owned
Corporate Headquarters		
White Plains, New York	54	Leased

ITEM 3. LEGAL PROCEEDINGS

From time to time, we are involved in legal proceedings that are incidental to the operation of our businesses. Some of these proceedings allege damages relating to personal injury claims, environmental exposures, intellectual property matters, commercial or contractual disputes, sometimes related to acquisitions or divestitures, and employment and pension matters. We will continue to defend vigorously against all claims. See information provided below and Note 20 to the Consolidated Financial Statements for further information.

Asbestos Proceedings

ITT, including its subsidiary Goulds Pumps, Inc, has been joined as a defendant with numerous other companies in product liability lawsuits alleging personal injury due to asbestos exposure. These claims allege that certain of our products sold prior to 1985 contained a part manufactured by a third party (e.g., a gasket) which contained asbestos. To the extent these third-party parts may have contained asbestos, it was encapsulated in the gasket (or other) material and was non-friable. In certain other cases, it is alleged that former ITT companies were distributors for other manufacturers' products that may have contained asbestos. Frequently, the plaintiffs are unable to identify any ITT or Goulds Pump product as a source of asbestos exposure. In addition, in a large majority of the claims against the Company, the plaintiffs are unable to demonstrate any injury. Many of those claims have been placed on inactive dockets. Our experience to date is that a substantial portion of resolved claims have been dismissed without payment by the Company.

We record a liability for pending asbestos claims and asbestos claims estimated to be filed over the next 10 years. While it is probable that we will incur additional costs for future claims to be filed against the Company, a liability for potential future claims beyond the next ten years is not reasonably estimable due to a number of factors. As of December 31, 2011, we have recorded an undiscounted asbestos-related liability for pending claims and unasserted claims estimated to be filed over the next 10 years of $1,668, including expected legal fees, and an associated asset of $954, which represents estimated recoveries from insurers and other responsible parties, resulting in a net asbestos exposure of $714.

Other Matters

On December 20, 2011, the Ad Hoc Committee of ITT Bondholders filed a Complaint in New York State court alleging that ITT breached the early redemption provisions of certain bonds issued in 2009. In 2009, ITT issued $500 in bonds maturing in 2019 at an interest rate of 6.125%. The documents governing the bonds contained certain provisions governing early redemptions. On September 20, 2011, ITT notified the holders of the debt that it intended to redeem the bonds on October 20, 2011 in accordance with the terms of the governing documents. On October 18, 2011, the redemption price was disclosed. The Plaintiffs contend that ITT used an improper discount rate in calculating the redemption price and otherwise failed to comply with required redemption procedures. If the Plaintiffs' claims are sustained, ITT could be required to pay up to $15 in additional redemption fees and interest to all holders of the bonds; however, the costs associated with this matter, if any, will be shared with Exelis and Xylem in accordance with the Distribution Agreement as described in Note 4, "Discontinued Operations" to the Consolidated Financial Statements. Management believes that these matters will not have a material adverse effect on our consolidated financial position, results of operations or cash flows.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

EXECUTIVE OFFICERS OF THE REGISTRANT

The following information is provided regarding the executive officers of ITT. Each of the executive officers was elected to his or her position by the Company's Board of Directors.

NAME	AGE AT 2/1/12	CURRENT TITLE	OTHER BUSINESS EXPERIENCE DURING PAST 5 YEARS
Denise L. Ramos	55	Chief Executive Officer and President (2011)	Senior Vice President and Chief Financial Officer, (2007)
Aris C. Chicles	50	Executive Vice President, Strategy (2011)	Senior Vice President, Director of Strategy and Corporate Development (2008); Vice President, Director of Strategy and Corporate Development, ITT (2006)
Burt M. Fealing	42	Senior Vice President, General Counsel and Secretary (2011)	Vice President and Corporate Secretary (2010); Vice President, Corporate Secretary and Chief Securities Counsel, SUPERVALU INC. (2007)
Janice M. Klettner	51	Vice President, Chief Accounting Officer and Assistant Secretary (2008)	Chief Accounting Officer and Assistant Secretary, ITT (2006)
Thomas F. Korber	48	Senior Vice President and Chief Human Resources Officer (2011)	Towers Watson, Senior Consultant (2006)
Munish Nanda	47	Senior Vice President and President, Control Technologies (2011)	President, Control Technologies (2011); Vice President and Director, Integrated Supply Chain (2008); Vice President, General Manager Temperature Control Products, Thermo Fisher Scientific (2007)
Robert J. Pagano, Jr.	49	Senior Vice President and President, Industrial Process (2011)	President, Industrial Process (2009); Vice President Finance (2006)
Luca Savi	45	Senior Vice President and President, Motion Technologies (2011)	Chief Operating Officer, World, Comau Inc. (2009); President and Chief Executive Officer, Comau USA (2007)
Thomas M. Scalera	40	Senior Vice President and Chief Financial Officer (2011)	Vice President of Corporate Finance (2010); Director, Investor Relations (2008); Director Financial Planning and Analysis (2006)
William E. Taylor	59	Senior Vice President and President, Interconnect Solutions (2011)	President, Interconnect Solutions (2008); President ITT China & India (2006)

Note: Date in parentheses indicates the year in which the position was assumed.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

COMMON STOCK – MARKET PRICES AND DIVIDENDS

On October 31, 2011 (the Distribution Date), ITT completed the spin-offs of Exelis and Xylem and the common stock of each was distributed, on a pro rata basis, to the Company's shareholders of record as of the close of business October 17, 2011 (the "Record Date"). On the Distribution Date, each ITT shareholder received one share of Exelis common stock and one share of Xylem common stock for every share of ITT common stock held on the Record Date. ITT completed a one-for-two reverse stock split of ITT common stock after the market close on October 31, 2011.

The table below reflects the range of market prices of our common stock as reported in the consolidated transaction reporting system of the New York Stock Exchange (NYSE), the principal market in which this security is traded (under the trading symbol "ITT") and has been adjusted for the reverse stock split; however the historical prices prior to the Distribution have not been adjusted for the impact of the Distribution. ITT common stock is also listed on the Euronext Exchange under the "ITT" trading symbol. In February 2012, a decision was made by the Board of Directors to delist from the Euronext Exchange following the payment of our first quarter 2012 dividend in April 2012.

	2011		2010	
	HIGH	**LOW**	HIGH	LOW
Three Months Ended:				
March 31	**$128.00**	**$103.60**	$111.22	$94.82
June 30	**122.08**	**108.80**	115.98	88.34
September 30	**120.26**	**80.50**	101.58	84.10
December 31(1)	**94.98**	**16.67**	106.48	90.12

(1) On October 31, 2011, we completed the Distribution of Exelis and Xylem. On October 31, 2011, the closing price of our common stock on the NYSE was $91.20. On November 1, 2011, the first day of "regular-way" trading following the Distribution, the opening price of our common stock on the NYSE was $17.02 and the opening prices for Exelis common stock and Xylem common stock were $10.33 and $25.60, respectively. The opening prices for Exelis and Xylem do not reflect an adjustment for the ITT common stock one-for-two reverse stock split.

During the period from January 1, 2012 through January 31, 2012, the high and low reported market prices of our common stock were $22.39 and $19.52, respectively.

After giving effect to the 1:2 Reverse Stock Split, we declared dividends of $0.50 per share of common stock in each of the four quarters of 2010 and the first three quarters of 2011, respectively. We declared a dividend of $0.091 per share of common stock in the fourth quarter of 2011. In the first quarter of 2012, we declared a dividend of $0.091 per share for shareholders of record on March 7, 2012. The amount and timing of dividends payable on our common stock are within the sole discretion of our Board of Directors and will be based on, and affected by, a number of factors, including our financial position and results of operations, available cash, expected capital spending plans, prevailing business conditions, and other factors the Board deems relevant. Therefore, there can be no assurance as to what level of dividends, if any, will be paid in the future.

There were approximately 17,600 holders of record of our common stock on February 10, 2012.

EQUITY COMPENSATION PLAN INFORMATION

The information called for by Item 5(a) is incorporated herein by reference to the portions of the definitive proxy statement referred to in Item 10 of this Annual Report on Form 10-K set forth under the caption "Equity Compensation Plan Information."

ISSUER PURCHASES OF EQUITY SECURITIES

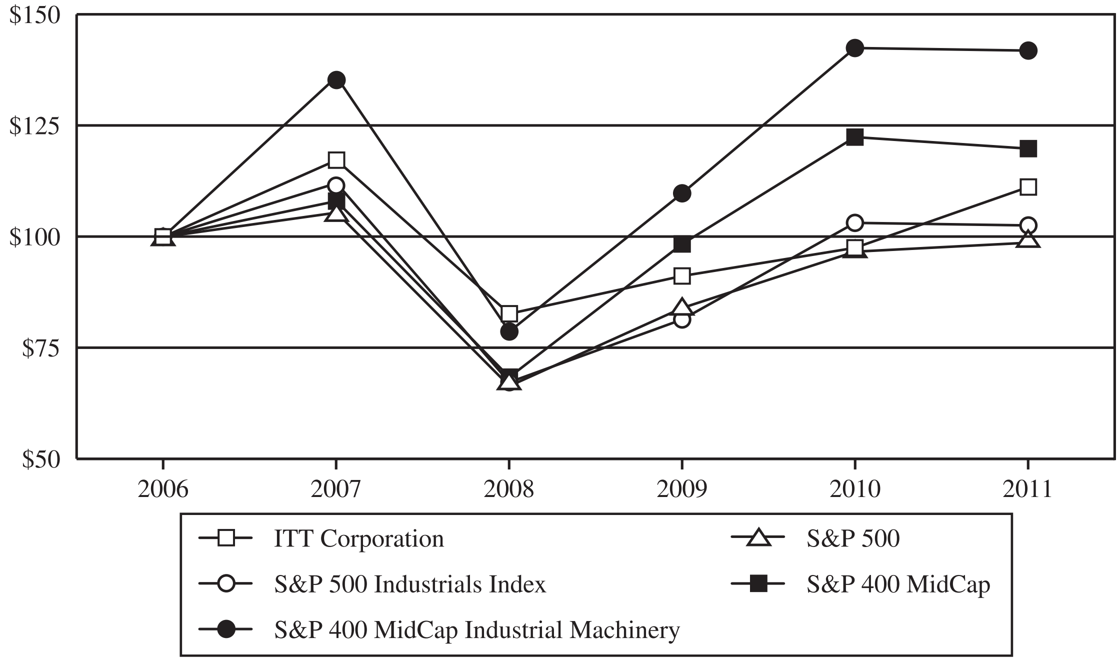
The following table summarizes our purchases of our common stock for the quarter ended December 31, 2011.

(IN MILLIONS) PERIOD	TOTAL NUMBER OF SHARES PURCHASED	AVERAGE PRICE PAID PER SHARE(1)	TOTAL NUMBER OF SHARES PURCHASED AS PART OF PUBLICLY ANNOUNCED PLANS OR PROGRAMS(2)	MAXIMUM DOLLAR VALUE OF SHARES THAT MAY YET BE PURCHASED UNDER THE PLANS OR PROGRAMS(2)
10/1/11 – 10/31/11	–	–	–	$569
11/1/11 – 11/30/11	–	–	–	$569
12/1/11 – 12/31/11	–	–	–	$569

(1) Average price paid per share is calculated on a settlement basis and excludes commission.

(2) On October 27, 2006, a three-year $1 billion share repurchase program was approved by our Board of Directors. On December 16, 2008, the provisions of the share repurchase program were modified by our Board of Directors to replace the original three-year term with an indefinite term. As of December 31, 2011, we had repurchased 3.55 million shares for $431, including commission fees, under the $1 billion share repurchase program. The program is consistent with our capital allocation process, which has centered on those investments necessary to grow our businesses organically and through acquisitions, while also providing cash returns to shareholders. Our strategy for cash flow utilization is to invest in our business, pay dividends, execute strategic acquisitions and repurchase common stock.

PERFORMANCE GRAPH
CUMULATIVE TOTAL RETURN
Based upon an initial investment on December 31, 2006 of $100 with dividends reinvested



	12/31/06	12/31/07	12/31/08	12/31/09	12/31/10	12/31/11
ITT Corporation[(a)]	$100.00	$117.26	$82.73	$91.24	$97.60	$111.28
S&P 500	$100.00	$105.49	$66.46	$84.05	$96.71	$98.76
S&P 500 Industrials	$100.00	$112.04	$67.31	$81.40	$103.16	$102.55
S&P 400 MidCap	$100.00	$107.98	$68.46	$98.37	$122.44	$119.89
S&P 400 MidCap Industrial Machinery	$100.00	$135.93	$78.62	$109.77	$142.49	$141.86

(a) On November 1, 2011, following the Distribution, ITT was removed from the S&P 500 Index and S&P 500 Industrial Index and was added to the S&P 400 MidCap Index and S&P 400 MidCap Industrial Machinery Index.

This graph is not, and is not intended to be, indicative of future performance of our common stock. This graph is not be deemed "filed" with the SEC or subject to the liabilities of Section 18 of the Securities Exchange Act of 1934, as amended (the Exchange Act), and should not be deemed to be incorporated by reference into any of our prior or subsequent filings under the Securities Act of 1933, as amended, or the Exchange Act.

ITEM 6. SELECTED FINANCIAL DATA

The following table presents selected historical financial data derived from the audited Consolidated Financial Statements and other Company information for each of the five years presented. Dividends declared and per share amounts have been restated for the 1:2 Reverse Stock Split which was effective October 31, 2011. Prior year amounts have been reclassified to reflect the discontinued operations of Exelis, Xylem and CAS, Inc (CAS) and gives effect to the immaterial corrections discussed in Note 23, "Immaterial Corrections," to the Consolidated Financial Statements. The selected financial data should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and the audited Consolidated Financial Statements and the Notes thereto.

(IN MILLIONS, EXCEPT PER SHARE AMOUNTS)	**2011**	2010	2009	2008	2007
Results of Operations					
Revenue[(a)]	**$2,119**	$ 1,908	$ 1,770	$ 2,132	$ 1,768
Gross profit	**655**	607	563	704	571
Gross margin	***30.9%***	*31.8%*	*31.8%*	*33.0%*	*32.3%*
Restructuring and asset impairment costs, net	**5**	3	43	25	12
Asbestos costs	**100**	385	238	14	14
Transformation costs	**396**	–	–	–	–
Other operating costs	**401**	403	403	454	342
Operating (loss) income[(b)]	**(247)**	(184)	(121)	211	203
Operating margin[(b)]	***(11.7)%***	*(9.6)%*	*(6.8)%*	*9.9%*	*11.5%*
(Loss) income from continuing operations	**(578)**	(132)	(111)	32	61
Income from discontinued operations, net of tax	**448**	936	740	706	685
Net (loss) income	**$ (130)**	$ 804	$ 629	$ 738	$ 746
(Loss) income from continuing operations per basic share	***$ (6.23)***	*$ (1.44)*	*$ (1.21)*	*$ 0.35*	*$ 0.67*
Income from discontinued operations per basic share	***$ 4.83***	*$ 10.19*	*$ 8.10*	*$ 7.76*	*$ 7.55*
Net income per basic share	***$ (1.40)***	*$ 8.75*	*$ 6.89*	*$ 8.11*	*$ 8.22*
(Loss) income from continuing operations per diluted share	***$ (6.23)***	*$ (1.44)*	*$ (1.21)*	*$ 0.35*	*$ 0.66*
Income from discontinued operations per diluted share	***$ 4.83***	*$ 10.19*	*$ 8.10*	*$ 7.67*	*$ 7.42*
Net income per diluted share	***$ (1.40)***	*$ 8.75*	*$ 6.89*	*$ 8.02*	*$ 8.08*
Dividends declared	**$1.591**	$ 2.00	$ 1.70	$ 1.40	$ 1.12
Financial Position					
Cash and cash equivalents[(c)]	**$ 690**	$ 206	$ 187	$ 203	$ 342
Total assets[(d)]	**3,671**	12,615	11,195	10,614	11,982
Total debt[(e)]	**6**	1,360	1,506	2,147	3,566

(a) In September 2007, we acquired International Motion Control (IMC). This business contributed consolidated revenue growth of $147 in 2008.

(b) The decline in operating income from 2010 to 2011 is primarily attributable to $396 of Transformation costs incurred to complete the Distribution of Exelis and Xylem (Transformation costs), including debt extinguishment costs of $297, partially offset by a $285 decline in net asbestos costs. The Transformation costs decreased 2011 operating margins by 1,870 basis points. See Note 3, "Company Transformation," to the Consolidated Financial Statements for further information on the Distribution.

The decline in operating income and operating margin from 2008 to 2009 and 2009 to 2010 is primarily attributable to the recognition of a net asbestos liability related to pending claims and unasserted claims estimated to be filed over the next 10 years. The 2011, 2010 and 2009 asbestos charges, net of estimated recoveries from insurers and other responsible parties, included in operating income were $100, $385 and $238, respectively. The asbestos charges decreased operating margins by 470 basis points, 2,020 basis points and 1,345 basis points in 2011, 2010 and 2009, respectively. Prior to 2009, we recorded an asbestos liability and related assets associated with pending claims only. It is probable that we will incur additional liabilities for asbestos claims filed beyond our current 10-year horizon and such liabilities may be material. See Note 20, "Commitments and Contingencies," to the Consolidated Financial Statements for further information on the Distribution.

(c) The increase in cash and cash equivalents from 2010 to 2011 was primarily due to receipt of a net cash transfer (the Contribution) of $729 and $857 from Exelis and Xylem, respectively, in connection with the Distribution, offset in part by the extinguishment of $1,251 of long-term debt in October 2011.

(d) The decline in total assets from 2010 to 2011 is primarily attributable to the Distribution of Exelis and Xylem on October 31, 2011, which had total combined assets of $9,322 as of December 31, 2010. The assets of Exelis and Xylem, although presented as discontinued operations, are included in the total asset amounts for 2007 through 2010.

(e) The decline in total debt from 2010 to 2011 is primarily due to the extinguishment of $1,251 of long-term debt in October 2011. The year-over-year declines in total debt in 2008 and 2009 was due to repayments of outstanding commercial paper balances.

ITEM 7. MANAGEMENT'S DISCUSSION & ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(In millions, except per share amounts, unless otherwise stated)

OVERVIEW

ITT Corporation (references herein to "ITT," "the Company," and such words as "we," "us," and "our" include ITT Corporation and its subsidiaries) is a diversified manufacturer of highly engineered critical components and customized technology solutions for growing industrial end-markets. Building on its heritage of innovation, ITT partners with its customers to deliver enduring solutions to the key industries that underpin our modern way of life. We manufacture key components that are integral to the operation of systems and manufacturing processes in the electronics, energy & mining, transportation, aerospace, and related industrial markets. Our products provide enabling functionality for applications where reliability and performance are critically important for our customers and the end users of their products.

Our businesses share a common, repeatable operating model. Each business applies technology and engineering expertise to solve our customer's most pressing challenges. Our applied engineering adeptness provides a superior business fit with our customers given the critical nature of their applications. This in turn provides us with a strong degree of knowledge of our customer's requirements and how we can help them to achieve their business goals. Our technology and customer intimacy in tandem produce opportunities to capture recurring revenue streams aftermarket opportunities and long lived original equipment manufacturer (OEM) platforms.

Our product and service offerings are organized into four segments: Industrial Process, Motion Technologies, Interconnect Solutions (ICS), and Control Technologies. Our segments generally operate with strong niche positions in large, attractive markets where specialized engineered solutions are required to support large industrial and transportation customer needs.

- *Industrial Process* manufactures engineered fluid process equipment serving a diversified mix of customers in global infrastructure industries such as oil & gas, mining, power generation, chemical and other process markets and is an aftermarket service provider.
- *Motion Technologies* manufactures brake pad, shock absorber and damping technologies for the global automotive, truck, trailer and public bus and rail transportation markets.
- *Interconnect Solutions* manufactures a wide range of highly specialized connector products that make it possible to transfer signal and power in various electronic devices that are utilized in aerospace, industrial, defense and oil & gas markets.
- *Control Technologies* manufactures specialized equipment, including actuation, valves, switches, vibration isolation, custom-energy absorption, and regulators for the aerospace, military and industrial markets.

On October 31, 2011 (the Distribution Date), ITT completed the spin-off of Exelis Inc. (Exelis), formerly ITT's Defense and Information Solutions segment, and Xylem Inc. (Xylem), formerly ITT's water-related business, by way of a distribution (the Distribution) of all of the issued and outstanding shares of Exelis common stock and Xylem common stock, on a pro rata basis, to ITT shareholders of record on October 17, 2011 (the Record Date). On the Distribution Date, each ITT shareholder received one share of Exelis common stock and one share of Xylem common stock for every share of ITT common stock held on the Record Date. Exelis and Xylem are now independent companies trading on the New York Stock Exchange under the symbols "XLS" and "XYL", respectively. The Distribution was made pursuant to a Distribution Agreement, dated October 25, 2011, among ITT, Exelis and Xylem (the Distribution Agreement). The net assets and results of Exelis and Xylem prior to the Distribution are classified as discontinued operations. See Note 3, "Company Transformation," to the Consolidated Financial Statements for further information on the Distribution.

EXECUTIVE SUMMARY

ITT reported revenue of $2,119 for the year ended December 31, 2011, an increase of 11.1% from $1,908 reported in 2010. Growth in emerging markets of 19.1% and our core markets, including oil & gas, mining, transportation and aerospace drove the increase in revenue. Operating loss increased $63, primarily due to $396 of costs incurred to complete the Distribution of Exelis and Xylem, including debt extinguishment costs of $297, partially offset by a $285 reduction in asbestos-related costs and a $39 increase in segment operating income, reflecting 17.0% growth as compared to the prior year. Driven by Transformation costs and income tax expense, full year 2011 results ended with a loss from continuing operations of $578 or $6.23 per share.

Adjusted income from continuing operations was $117 for 2011, reflecting an increase of $43, or 58.1%, over the prior year. Our adjusted income from continuing operations translated into $1.24 per diluted share, a $0.44 or 55.0% increase over the prior year. See the "Key Performance Indicators and Non-GAAP Measures," section included within

Management's Discussion and Analysis for a reconciliation of the adjusted non-GAAP measures.

Additional highlights for 2011 include the following:

- On October 31, 2011, ITT completed the Distribution of its Defense and Water businesses and with it created two new publicly traded companies, Exelis and Xylem. ITT is now an industrial company with $2.1 billion of revenue derived from four segments that deliver highly engineered and customized products and services focused on the industrial, aerospace, transportation, and oil & gas markets.
- We extinguished $1.25 billion of long-term debt and terminated a $61 capital lease. We ended 2011 with a strong capital structure, including cash and cash equivalents of $690 and total debt of only $6.
- Segment operating income from continuing operations grew 17.0% during 2011, driven by double digit organic revenue growth at the consolidated level and within three of four segments.
- ITT secured a number of strategic wins during the fourth quarter of 2011 across all businesses, including six significant Industrial Process emerging market wins each in excess of $2, our first major Korean medical connector order and positions on two Embraer Aerospace programs.
- Emerging Markets provided a 19.1% increase to revenue during 2011, reflecting growth in each of our targeted economies, China, India, Brazil and the Middle East.
- On October 27, 2011, ITT acquired Blakers Pump Engineers (Blakers), a long-time distributor of ITT's Goulds Pumps brand in Australia. The acquisition will strengthen ITT's presence and capabilities in Australia and Asia especially in the oil and gas and mining industries.
- On October 31, 2011, Denise L. Ramos succeeded Steven R. Loranger as Chief Executive Officer and President of ITT Corporation. Frank T. MacInnis succeeded Mr. Loranger as Chairman of the ITT Board of Directors.
- On October 31, 2011, we completed a one-for-two reverse stock split (1:2 Reverse Stock Split) of ITT's common stock. Par value of our common stock remained $1 per share following the 1:2 Reverse Stock Split. All common stock shares authorized, issued and outstanding, as well as share prices and earnings per share give effect to the 1:2 Reverse Stock Split in all periods presented.

Further details related to these results are contained in the Discussion of Financial Results section.

Key Performance Indicators and Non-GAAP Measures

Management reviews key performance indicators including revenue, segment operating income and margins, earnings per share, orders growth, and backlog, among others. In addition, we consider certain measures to be useful to management and investors when evaluating our operating performance for the periods presented. These measures provide a tool for evaluating our ongoing operations and management of assets from period to period. This information can assist investors in assessing our financial performance and measures our ability to generate capital for deployment among competing strategic alternatives and initiatives, including, but not limited to, dividends, acquisitions, share repurchases and debt repayment. These metrics, however, are not measures of financial performance under accounting principles generally accepted in the United States of America (GAAP) and should not be considered a substitute for measures determined in accordance with GAAP. We consider the following non-GAAP measures, which may not be comparable to similarly titled measures reported by other companies, to be key performance indicators:

- "organic revenue" and "organic orders" are defined as revenue and orders, excluding the impact of foreign currency fluctuations and contributions from acquisitions and divestitures made during the current year. Divestitures include sales of insignificant portions of our business that did not meet the criteria for presentation as a discontinued operation. The period-over-period change resulting from foreign currency fluctuations assumes no change in exchange rates from the prior period.
- "adjusted segment operating income" defined as operating income, adjusted to exclude costs incurred in connection with the Distribution and restructuring charges and "adjusted operating margin" defined as adjusted operating income divided by total revenue.
- "adjusted income from continuing operations" and "adjusted income from continuing operations per diluted share" are defined as income from continuing operations and income from continuing operations per diluted share, adjusted to exclude special items that include, but are not limited to, asbestos-related costs, Transformation costs, restructuring and asset impairment charges, income tax settlements or adjustments, and other unusual or infrequent non-operating items. Special items represent significant charges or credits that impact current results, but may not be related to the Company's ongoing operations and performance. A reconciliation of adjusted income from continuing operations, including adjusted earnings per diluted share, is provided below.

	2011	2010	2009
Loss from continuing operations[(a)]	**$ (578)**	$ (132)	$ (111)
Transformation costs, net of tax[(b)]	**257**	–	–
Net asbestos-related costs, net of tax[(c)]	**63**	241	143
Restructuring and asset impairment charges, net of tax	**3**	3	30
Legacy items and legal entity liquidation, net of tax	**(9)**	–	–
Interest income, net of tax	**(1)**	(6)	(9)
Tax-related special items[(d)]	**382**	(32)	7
Adjusted income from continuing operations	**$ 117**	$ 74	$ 60
Loss from continuing operations per basic share[(e)]	**$(6.23)**	$(1.44)	$(1.21)
Adjusted income from continuing operations per diluted share[(e)]	**$ 1.24**	$ 0.80	$ 0.63

(a) Loss from continuing operations includes interest expense associated with debt that was extinguished in October 2011 of $58, $75 and $50, for the years ended December 31, 2011, 2010 and 2009, respectively.

(b) The following table provides a reconciliation of Transformation costs to Transformation costs, net of tax, included as a special item. See Note 3, "Company Transformation" to the Consolidated Financial Statements for further information.

	2011	2010	2009
Transformation costs before tax	**$ 396**	$–	$–
Tax-related seperation costs	**4**	–	–
Tax benefit	**(143)**	–	–
Transformation costs, net of tax	**$ 257**	$–	$–

(c) The following table provides a reconciliation of net asbestos-related costs to net asbestos-related costs, net of tax, included as a special item. See Note 20, "Commitments and Contingencies," to our Consolidated Financial Statements for further information.

	2011	2010	2009
Net asbestos-related costs before taxes	**$100**	$ 385	$238
Tax benefit	**(37)**	(144)	(95)
Net asbestos-related costs, net of tax	**$ 63**	$ 241	$143

(d) The following table details significant components of the tax-related special items. See Note 7, "Income Taxes," to our Consolidated Financial Statements for further information.

	2011	2010	2009
Change in tax valuation allowance	**$340**	$(36)	$(19)
Charge on undistributed foreign earnings	**69**	–	–
Change in state tax rates	**(31)**	–	–
Write-off of deferred tax asset	**–**	12	–
Settlement of tax audit	**–**	(5)	–
Other	**4**	(3)	26
Net tax-related special items	**$382**	$(32)	$ 7

(e) Loss from continuing operations per share has been calculated using weighted average basic shares outstanding. Adjusted income from continuing operations per share has been calculated using weighted average diluted shares outstanding.

- "free cash flow" is defined as net cash provided by operating activities less capital expenditures, cash payments for Transformation costs and other significant items that impact current results which management believes are not related to our ongoing operations and performance. Due to other financial obligations and commitments, the entire free cash flow may not be available for discretionary purposes. A reconciliation of free cash flow is provided below.

	2011	2010	2009
Net cash from continuing operations	**(323)**	(77)	261
Capital expenditures[(f)]	**(85)**	(127)	(92)
Transformation cash payments	**355**	–	–
Free cash flow	**(53)**	(204)	169

(f) Capital expenditures in 2011 represents capital expenditures as reported in the Statement of Cash Flows, less capital expenditures associated with the Transformation of $18.

DISCUSSION OF FINANCIAL RESULTS

2011 VERSUS 2010

	2011	2010	CHANGE
Revenue	**$2,119**	$1,908	11.1%
Gross profit	**655**	607	7.9%
Gross margin	***30.9%***	*31.8%*	*(90)bp*
Operating expenses	**902**	791	14.0%
Operating expense to revenue ratio	***42.6%***	*41.5%*	*110bp*
Operating loss	**(247)**	(184)	34.2%
Operating margin	***(11.7)%***	*(9.6)%*	*(210)bp*
Interest and non-operating expenses, net	**71**	92	(22.8)%
Income tax expense (benefit)	**260**	(144)	(280.6)%
Loss from continuing operations	**(578)**	(132)	337.9%
Income from discontinued operations, net of tax	**448**	936	(52.1)%
Net (loss) income	**$ (130)**	$ 804	(116.2)%

REVENUE

Our revenue results for 2011 reflect growth in emerging markets of 19.1% and in our core markets, such as oil & gas, mining, transportation and aerospace. Our results also benefited from the continued economic recovery within the North American region, increasing production of commercial aircraft, and transportation share gains combined with a recovery in global automotive demand. During 2011, we secured positions on multiple key platforms and developed strategic account agreements with a number of significant customers, including six significant Industrial Process emerging market wins each in excess of $2, our first major Korean medical connector order and positions on two Embraer Aerospace programs.

	2011	2010	CHANGE
Industrial Process	**$ 767**	$ 694	10.5%
Motion Technologies	**634**	548	15.7%
Interconnect Solutions	**418**	413	1.2%
Control Technologies	**318**	275	15.6%
Eliminations	**(18)**	(22)	(18.2)%
Total	**$2,119**	$1,908	11.1%

The following table illustrates revenue generated with a specific country or region for the years ended December 31, 2011 and 2010, and the corresponding percentage change.

	2011	2010	% Change
United States	**$ 792**	$ 742	6.7%
Germany	**233**	205	13.7%
France	**127**	117	8.5%
Other developed markets	**368**	341	7.9%
Total developed markets	**1,520**	1,405	8.2%
South and Central America[(a)]	**179**	139	28.8%
Eastern Europe and Russia	**107**	68	57.4%
Middle East and Africa	**100**	101	(1.0)%
China and Hong Kong	**119**	115	3.5%
Other emerging markets	**94**	80	17.5%
Total emerging markets	**599**	503	19.1%
Total Revenue	**$2,119**	$1,908	11.1%

(a) Includes Mexico

The following table illustrates the impact from organic growth, recent acquisitions, and fluctuations in foreign currency, in relation to revenue during 2011.

	Industrial Process	Motion Technologies	Interconnect Solutions	Control Technologies	Eliminations	Total ITT	% Change
2010 Revenue	$694	$548	$413	$275	$(22)	$1,908	
Organic growth	61	59	(1)	41	4	164	8.6%
Acquisitions/(divestitures), net	7	–	(2)	–	–	5	0.3%
Foreign currency translation	5	27	8	2	–	42	2.2%
Total change in revenue	73	86	5	43	4	211	11.1%
2011 Revenue	$767	$634	$418	$318	$(18)	$2,119	

Industrial Process

The Industrial Process segment generated revenue growth of 10.5% reflecting growth in aftermarket (pump parts and service) of approximately 17% and pump units of approximately 8%. This includes growth in our North American business of approximately 7% reflecting positive results across all industrial markets. The chemical market in the U.S. and Canada was a major contributor to the growth as chemical companies increased output due to lower cost North American natural gas feedstock. Growth in international pump units of 14% reflects increased activity in South America and the Middle East, primarily within the oil & gas market, partially offset by a decline in revenue from a large 2010 project in Africa. The Industrial Process revenue results include 21% growth in emerging markets and also reflect the benefits from product development investments in more complex and specialized equipment.

Orders increased during 2011 by 27.5% to $917 in both baseline and project business stemming from expanded capabilities focused on the oil & gas and mining markets as well as expanded presence in growth regions, including acquisitions. Fourth quarter 2011 orders were $235 or 30.5% higher than the prior year, primarily driven by the North American chemical market and emerging market oil & gas projects and mining. Backlog as of December 31, 2011 was $489, representing a 54.1% increase over the prior year, and an all-time high for Industrial Process.

Motion Technologies

The Motion Technologies segment generated revenue growth of 15.7% during 2011, primarily driven by a 12% or $54 increase in braking equipment volume, primarily to OEM. The increase in OEM pads stems from the significant automotive platform wins over the past several years, which included new positions with European, North American and Chinese producers. Sales of shock absorber equipment increased 6%, or $6, however results were negatively impacted by the Chinese government's decision to slow the development of the China rail infrastructure expansion program in the second half of 2011. Motion Technologies' 2011 revenue results included 33% growth in emerging markets driven by automotive and rail activity in China and a combined growth of 20% within the United States and Canada.

Interconnect Solutions

The ICS segment generated revenue growth of 1.2% during 2011, as strength in the aerospace, transportation, oil & gas, and defense markets were offset by an approximate 20% revenue decline in the communications market. The year-over-year decrease within the communications market equipment reflects a decline in sales primarily due to lower production rates at a major smartphone customer and share declines in a specific communications application. Revenue growth within the aerospace market was approximately 7%, due to increased Boeing production and regional jet OEM demand. Revenue growth within the transportation market was approximately 10%, driven by our recently launched electronic vehicle-related connector products and construction and agriculture equipment platform wins in Europe and China. Revenue growth within the oil & gas market was approximately 9%, driven by increased demand in the Middle East and Latin America regions. Revenue growth in the defense market was approximately 5%, driven by radar and communication equipment platform wins.

Control Technologies

The Control Technologies segment generated revenue growth of 15.6% during 2011, with growth in the aerospace and industrial markets, partially offset by a 10% decline in defense revenues. Revenue within the aerospace market grew approximately $19, or 12% driven by 2011 Boeing and Airbus production increases. Industrial market revenues grew approximately $14 or 13%, primarily driven by increased demand for oil & gas and energy products, such as our Neo-Dyne switches and Conoflow regulators. Chinese rail infrastructure activities provided revenue growth of $10 related to a first-class seats program that is not expected to be meaningful in 2012.

GROSS PROFIT

	2011	2010	CHANGE
Industrial Process	**$ 244**	$ 216	13.0%
Motion Technologies	**157**	153	2.6%
Interconnect Solutions	**134**	142	(5.6)%
Control Technologies	**119**	95	25.3%
Corporate and Other	**1**	1	–
Total gross profit	**$ 655**	$ 607	7.9%
Gross margin:			
Industrial Process	**31.8%**	31.1%	70bp
Motion Technologies	**24.8%**	27.9%	(310)bp
Interconnect Solutions	**32.1%**	34.4%	(230)bp
Control Technologies	**37.4%**	34.5%	290bp

Industrial Process gross profit increased $28 or 13.0% during 2011 due to increased sales volume and net cost reductions from material sourcing initiatives. These items drove an increase to gross margin of 70 basis points over the prior year to 31.8%.

Motion Technologies gross profit increased $4 or 2.6% during 2011 from increased sales volume, however gross margin declined 310 basis points to 24.8%. The decline in gross margin was due to increasing material costs and an unfavorable mix shift attributable to recent OEM share gains between 2010 and 2011.

Interconnect Solutions gross profit decreased $8 or 5.6%, representing a 230 basis point decline, during 2011 due to an unfavorable change in product sales mix, partially offset by favorable product pricing.

Control Technologies gross profit increased $24 or 25.3% during 2011 due to increased sales volume, improved pricing, favorable mix, and operational performance improvements related to recent footprint consolidations and leadership changes. These favorable items were partially offset by increased labor, material and overhead costs. These items drove an increase to gross margin of 290 basis points over the prior year to 37.4%.

OPERATING EXPENSES

Operating expenses increased 14.0% or $111 during 2011 to $902, primarily attributable to a $396 of costs incurred to complete the Distribution of Exelis and Xylem, including debt extinguishment costs of $297, partially offset by a $285 reduction in asbestos-related costs. The following table provides further information by expense type, as well as a breakdown of operating expense by segment.

	2011	2010	CHANGE
Sales and marketing expenses	**$167**	$166	0.6%
General and administrative expenses	**168**	176	(4.5)%
Research and development expenses	**66**	61	8.2%
Restructuring and asset impairment charges, net	**5**	3	66.7%
Asbestos-related costs, net	**100**	385	(74.0)%
Transformation costs	**396**	–	–
Total operating expenses	**$902**	$791	14.0%
By Segment:			
Industrial Process	**$153**	$137	11.7%
Motion Technologies	**72**	68	5.9%
Interconnect Solutions	**96**	105	(8.6)%
Control Technologies	**64**	66	(3.0)%
Corporate & Other	**517**	415	24.6%

Sales and marketing expenses were relatively flat year-over-year; however, due to our value-based commercial excellence (VBCE) initiative these costs as a percentage of revenue declined 130 basis points at the consolidated level from 9.2% in 2010 to 7.9% in 2011, with similar basis point declines at each segment. VBCE is a continuous improvement process which our businesses use to strategically price our products and services, develop our value propositions, and assist our customers to solve their toughest business challenges.

G&A expenses decreased $8 or 4.5% during 2011, as additional postretirement costs of $8 were partially offset by a $10 cancellation of a bond guarantee and a $4 gain on the sale of an ICS' product line.

R&D costs increased 8.2% over the prior year due to slightly higher spending on new product developments in targeted growth markets at each segment. As a percentage of revenue, R&D costs declined to 3.1% in 2011 from 3.2% in 2010. We anticipate our investments in future R&D activities will moderately increase from current spending levels to ensure a continuing flow of innovative, high quality products and maintain our competitive position in the markets we serve.

Asbestos-Related Costs, Net

ITT, including its subsidiary Goulds Pumps, Inc., has been joined as a defendant with numerous other companies in product liability lawsuits alleging personal injury due to asbestos exposure. As of December 31, 2011 and 2010, there were 105,486 and 103,575 open claims pending against ITT filed in various state and federal courts alleging injury as a result of exposure to asbestos. We record an undiscounted asbestos liability, including legal fees, for costs that the Company is estimated to incur to resolve all pending claims, as well as unasserted claims estimated to be filed over the next 10 years. We also record a corresponding asbestos-related asset that represents our best estimate of probable recoveries from insurers and other responsible parties for the estimated asbestos liabilities.

The Company records a net asbestos charge each quarter to maintain a rolling 10 year forecast period (referred to as the Provision). In addition, in the third quarter of each year, we conduct an annual study to review and update the underlying assumptions used in our asbestos liability and related asset estimates (referred to as Remeasurement). During the annual study, the underlying assumptions are updated based on our actual experience since our last annual study, a reassessment of the appropriate reference period of years of experience used in determining each assumption and our expectations regarding future conditions, including inflation. For the years ended December 31, 2011 and 2010, the income statement effects to continuing operations from asbestos charges consisted of the following:

	December 31, 2011			December 31, 2010		
	Liability	**Asset**	**Net**	Liability	Asset	Net
Provision	**$ 85**	**$26**	**$ 59**	$ 67	$ 12	$ 55
Remeasurement	**38**	**(3)**	**41**	524	194	330
Asbestos-related costs before tax	**123**	**23**	**100**	591	206	385
Tax benefit			**(37)**			(144)
Asbestos-related costs, net of tax			**$ 63**			$ 241

Charges included in the table above reflect undiscounted costs that the Company is estimated to incur to resolve all pending claims, as well as unasserted claims estimated to be filed over the next 10 years, including legal fees. The decrease in our Remeasurement expense from 2010 to 2011 reflects the impact of our annual update to the underlying assumptions used to measure our asbestos liabilities and related assets and was a result of several developments including a reduction in the assumed rate of increase in future average settlement costs and an expectation of lower defense costs relative to indemnities paid. These favorable factors were offset in part by increased activity in several higher-cost jurisdictions, increasing the number of cases expected to be adjudicated. The 2010 Remeasurement reflects an assumed increase in settlement costs and significantly increased activity in several higher-cost jurisdictions, increasing the number of cases to be adjudicated and the expected legal costs to defend the additional cases.

See Note 20, "Commitments & Contingencies," to the Consolidated Financial Statements for further information on our asbestos-related liability and assets.

Transformation Costs

During 2011, we recognized expenses of $639 in connection with the Transformation. We have presented $396 of the Transformation costs within income from continuing operations and $240 within income from discontinued operations. The components of Transformation costs incurred during 2011 and included within income from continuing operations are presented below.

Loss on extinguishment of debt(a)	$297
Non-cash asset impairment(b)	57
Employee retention and other compensation costs(c)	37
IT costs	–
Lease termination and other real estate costs	4
Other costs	1
Transformation costs before income tax expense	396

(a) The $297 loss on extinguishment of debt represents the costs to extinguish substantially all outstanding debt prior to the Distribution. The activities associated with the extinguishment of debt are described in Note 16. "Debt," to the Consolidated Financial Statements.

(b) Includes $55 non-cash impairment charge related to a decision to discontinue development of an information technology consolidation initiative.

(c) Includes $17 of compensation costs recognized in connection with the retirement of Steven R. Loranger, our Former Chairman, President and Chief Executive Officer in October 2011.

The Company expects to incur additional cash and non-cash Transformation costs during 2012 of approximately $15 to $20, net of tax, primarily consisting of additional advisory fees. The Company anticipates net after-tax cash outflows during 2012 of approximately $30 to $40, primarily related to advisory fees and employee-related costs.

OPERATING LOSS

	2011	2010	CHANGE
Industrial Process	**$ 91**	$ 79	15.2%
Motion Technologies	**85**	85	–
Interconnect Solutions	**38**	37	2.7%
Control Technologies	**55**	29	89.7%
Segment operating income	**269**	230	17.0%
Asbestos-related costs, net	**(100)**	(385)	(74.0)%
Transformation costs	**(396)**	–	–
Other corporate costs	**(20)**	(29)	(31.0)%
Total operating loss	**$ (247)**	$(184)	34.2%
Operating margin:			
Consolidated operating margin	**(11.7)%**	(9.6)%	(210)bp
Segment operating margin	**12.7%**	12.1%	60bp
Industrial Process	**11.9%**	11.4%	50bp
Motion Technologies	**13.4%**	15.5%	(210)bp
Interconnect Solutions	**9.1%**	9.0%	10bp
Control Technologies	**17.3%**	10.5%	680bp

Industrial Process operating income increased $12 or 15.2% during 2011 due to increased sales volume and net cost reductions from productivity, sourcing and Value Based Lean Six Sigma initiatives. The favorability of these items was partially offset by competitive project pricing levels, increased bad debt expense of $5 and Transformation costs of $3. These items resulted in a net increase to operating margin of 50 basis points over the prior year.

Motion Technologies operating income was flat at $85 for 2011. Although Motion Technologies generated revenue growth of 15.7% during 2011, this growth was volume driven from the lower margin OEM equipment associated with key wins on numerous automotive platforms in the last two years. This dynamic contributed to an overall 210 basis point decline in operating margin, as did rising material costs and increased year-over-year severance costs. The overall impact of these items was offset partially by strategic sourcing initiatives.

Interconnect Solutions operating income increased $1 or 2.7% during 2011, as an unfavorable change in product sales mix and a $3 restructuring charge were offset by declines in warranty and compensation costs and a $4 gain from the sale of a product line.

Control Technologies operating income increased $26 or 89.7% during 2011 due to increased sales volume, improved pricing and favorable mix combined with operational improvements resulting from recent footprint actions. These results also include a favorable comparison to various 2010 inventory adjustments totaling $5. These favorable items were partially offset by increased labor, material and overhead costs. These items drove an increase to operating margin of 680 basis points over the prior year to 17.3%.

Corporate costs, excluding net asbestos-related costs and Transformation costs, decreased $9 during 2011, primarily due to a $10 gain from the cancellation of a bond guarantee, partially offset by a $3 unfavorable movement in the value of corporate owned life insurance policies.

INTEREST AND NON-OPERATING EXPENSES, NET

	2011	2010	CHANGE
Interest expense	**$76**	$97	(21.6)%
Interest income	**4**	11	(63.6)%
Miscellaneous (income) expense, net	**(1)**	6	(116.7)%
Total interest and non-operating expenses, net	**71**	92	(22.8)%

Total interest and non-operating expense, net decreased $21, or 22.8%, during 2011 due to the extinguishment of $1.25 billion of long-term debt in October 2011. We expect that our future interest expense will be significantly lower than our historical interest costs due to the extinguishment of $1.25 billion of debt in October 2011. In the future, we expect our interest expenses will be aligned with borrowing levels commensurate with the size of the Company following the distribution of Exelis and Xylem. See Note 16, "Debt" to the Consolidated Financial Statements for further information regarding the debt extinguishment.

INCOME TAX EXPENSE (BENEFIT)

During the year ended December 31, 2011, we recognized income tax expense of $260 on a loss from continuing operations before income taxes of $318, an effective rate of (81.8)%, as compared to an income tax benefit of $144 on a loss from continuing operations before income taxes of $276, an effective rate of 52.2%, in the prior year.

The effective tax rate recorded in 2011 differs from US federal statutory rate of 35% due to several items. First, in 2011, we recorded a valuation allowance of $340 for US federal and state deferred tax assets as it became more likely than not that these deferred tax assets would not be realized as a result of the Distribution. The valuation allowance decreased the effective tax rate benefit by 106.7%. As of December 31, 2011, the Company was in a cumulative three-year loss position, which was considered a significant source of negative evidence indicating the need for a valuation allowance on our net deferred tax assets. Since the Company was in a three-year cumulative loss position at the end of 2011, management determined that the size and frequency of the losses from continuing operations in recent years and the uncertainty associated with projecting future taxable income supported the conclusion that a valuation allowance was required to reduce its deferred tax assets.

Second, the Company recorded a $31 tax benefit in 2011 from an increase in state deferred tax assets which resulted in a 9.7% increase in the effective tax rate benefit. As a consequence of the Distribution, certain state deferred tax assets were re-valued based on enacted tax rates using different state apportionment factors, increasing the future state tax benefit. Third, in 2011 the Company also recorded $69 of tax expense for a portion of undistributed foreign earnings that were previously considered to be indefinitely re-invested which decreased the effective tax rate benefit by 21.8%. As a result of the Distribution and its impacts on the Company's expected liquidity, investment opportunities and other factors, the Company determined that certain earnings generated in Luxemburg, Japan, and South Korea may be distributed in the future. As a result of the change in intent, the Company recorded an additional tax expense on these unremitted earnings. Such undistributed foreign earnings have not been remitted to the U.S. and the timing of such remittance if any is currently under evaluation. The Company recorded a tax benefit of $23 for various tax credits, resulting in a tax rate benefit of 7.2%.

The effective tax rate in 2010 differs from the US federal statutory tax rate due to the release of a $36 valuation allowance on a capital loss carry-forward that increased the 2010 effective tax rate by 12.9%, related to the sale of CAS and $35 of tax credits which increased the effective tax rate by 12.6%. These items were offset in part by the writeoff of a deferred tax asset as a result of the Parent Protection Act of 2010.

INCOME FROM DISCONTINUED OPERATIONS, NET OF TAX

On October 31, 2011, the Company completed the Distribution of Exelis and Xylem. As a result, the operating results of Exelis and Xylem through the date of the Distribution have been classified in the consolidated financial statements as discontinued operations for all periods presented. The tables included below provide the operating results of discontinued operations through the date of disposal or distribution.

Year Ended 2011	Exelis	Xylem	Other[b]	Total
Revenue	$4,916	$3,107	$ –	$8,023
Transformation costs	31	75	134	240
Earnings (loss) before income taxes	473	321	(108)	686
Income tax expense (benefit)	194	70	(26)	238
Income (loss) from discontinued operations	279	251	(82)	448

Year Ended 2010	Exelis[a]	Xylem	CAS	Other[b]	Total
Revenue	$5,893	$3,192	$160	$ –	$9,245
Earnings before income taxes	718	395	13	12	1,138
Gain on sale of disposal before tax	–	–	125	–	125
Income tax expense	251	51	–	25	327
Income (loss) from discontinued operations	467	344	138	(13)	936

(a) CAS was a component of our Defense and Information Solutions business, which was distributed as Exelis. The table above presents Exelis without CAS, which was disposed during 2010.

(b) Amounts presented in the "Other" column within the tables above relate to various divested ITT businesses accounted for as discontinued operations in the year of divestiture for which legacy liabilities remain, as well as certain Transformation costs which were directly related to the Distribution and provide no future benefit to the Company. See Note 3, "Company Transformation" for further information.

The components of Transformation costs incurred during 2011, and included within income from discontinued operations, are presented below.

Advisory fees	$139
IT costs	46
Employee retention and other compensation costs	20
Lease termination and other real estate costs	10
Non-cash asset impairment	8
Other costs	17
Transformation costs before income tax expense	240
Tax-related separation costs	7
Income tax benefit	(74)
Total transformation costs, net of tax impact	173

DISCUSSION OF FINANCIAL RESULTS

2010 VERSUS 2009

	2010	2009	CHANGE
Revenue	$1,908	$1,770	7.8%
Gross profit	607	563	7.8%
Gross margin	*31.8%*	*31.8%*	–
Operating expenses	791	684	15.6%
Expense to revenue ratio	*41.5%*	*38.6%*	*290bp*
Operating loss	(184)	(121)	52.1%
Operating margin	*(9.6)%*	*(6.8)%*	*(280)bp*
Interest and non-operating expenses, net	92	87	5.7%
Income tax benefit	(144)	(97)	48.5%
Loss from continuing operations	(132)	(111)	18.9%
Income from discontinued operations	936	740	26.5%
Net income	$ 804	$ 629	27.8%

REVENUE

Our 2010 revenue growth reflected recoveries in three of our businesses from the economic lows experienced during 2009. Overall revenue increased 7.8% reflecting growth in both emerging and developed markets as strength in our short cycle businesses was partially offset by a slower recovery in our late-cycle Industrial Process segment. In addition to the economic impact our business felt over the 2009-2010 period, our ICS segment gained market share with new products and platforms and our Motion Technologies segment continued to gain market share with key wins on various OEM platforms. The Control Technologies segment primarily benefited from a strengthening in the aerospace market. The following table illustrates the 2010 and 2009 revenue of our segments. See below for further discussion of year-over-year revenue activity at the segment level.

	2010	2009	CHANGE
Industrial Process	$ 694	$ 719	(3.5)%
Motion Technologies	548	491	11.6%
Interconnect Solutions	413	341	21.1%
Control Technologies	275	243	13.2%
Eliminations	(22)	(24)	(8.3)%
Total	$1,908	$1,770	7.8%

The following table illustrates revenue generated with a specific country or region for the years ended December 31, 2010 and 2009, and the corresponding percentage change.

	2010	2009	% Change
United States	$ 742	$ 710	4.5%
Germany	205	188	9.0%
France	117	101	15.8%
Other developed markets	341	305	11.8%
Total developed markets	1,405	1,304	7.7%
South and Central America[a]	139	116	19.8%
Eastern Europe and Russia	68	53	28.3%
Middle East and Africa	101	101	–
China and Hong Kong	115	98	17.3%
Other emerging markets	80	98	(18.4)%
Total emerging markets	503	466	7.9%
Total Revenue	$1,908	$1,770	7.8%

(a) Includes Mexico

The following table illustrates the impact from organic growth, recent acquisitions, and fluctuations in foreign currency, in relation to revenue during 2010.

	Industrial Process	Motion Technologies	Interconnect Solutions	Control Technologies	Eliminations	Total ITT	% Change
2009 Revenue	$719	$491	$341	$243	$(24)	$1,770	
Organic growth	(39)	82	75	33	12	163	9.2%
Acquisitions/(divestitures), net	5	–	–	(1)	–	4	0.2%
Foreign currency translation	9	(25)	(3)	–	(10)	(29)	(1.6)%
Total change in revenue	(25)	57	72	32	2	138	7.8%
2010 Revenue	$694	$548	$413	$275	$(22)	$1,908	

Industrial Process

The 2010 revenue generated by our Industrial Process segment was $694, reflecting a decline of $25 or 3.5% from the segment's 2009 revenue of $719. Growth from aftermarket (pump parts and service) of 3.5% partially offset lower revenue from pump units. The Industrial Process segment experienced a sharp decline in pump unit order activity during 2009, as economic conditions caused our customers to delay or cancel a significant number of planned projects. The decline in 2009 project orders led to lower revenues in 2010.

Motion Technologies

The Motion Technologies segment generated revenue growth of 11.6% during 2010, despite negative impacts from unfavorable foreign currency fluctuations of 5.1%. The growth reflected benefits from European automotive stimulus programs in place during the latter part of 2009 that bolstered demand and led to distributor inventory restocking in the early portions of 2010. In addition, key platform wins obtained during the past 18 months within Europe, North America and China increased our share in the OEM braking equipment market.

Interconnect Solutions

The ICS segment generated revenue growth of 21.1% during 2010, primarily driven by the overall strengthening and recovery within the majority of markets served. In addition, our results also included benefits from key 2010 platform wins on Smartphone devices that increased our share within the communications market. The release of our DL connector used in medical imaging equipment drove revenue growth of approximately 37% within the medical market. These results also reflect expansion within emerging markets on oil and gas related projects.

Control Technologies

The Control Technologies segment generated revenue growth of 13.2% during 2010, primarily reflecting an overall strengthening of the general industrial, aerospace and defense markets served by this division as compared to prior year. In addition, our revenue results further benefited by the increasing production of high-speed rail seating equipment in China.

GROSS PROFIT

Gross profit for 2010 was $607, representing a $44 increase, or 7.8% from 2009. Increased volume and significant net savings generated by productivity and other cost-reduction initiatives, more than offset rising material and labor costs. See further discussion on the 2010 net savings generated by our segments within the "Operating Income" discussion below. The following table illustrates the 2010 and 2009 gross profit results of our segments, including gross margin results.

	2010	2009	CHANGE
Industrial Process	$ 216	226	(4.4)%
Motion Technologies	153	133	15.0%
Interconnect Solutions	142	108	31.5%
Control Technologies	95	95	–
Corporate and Other	1	1	–
Total gross profit	$ 607	$ 563	7.8%
Gross margin:			
Industrial Process	31.1%	31.4%	(30)bp
Motion Technologies	27.9%	27.1%	80bp
Interconnect Solutions	34.4%	31.7%	270bp
Control Technologies	34.5%	39.1%	(460)bp

OPERATING EXPENSES

Operating expenses increased 15.6% or $107 during 2010 to $791, primarily attributable to a $147 increase in net asbestos-related costs resulting from unfavorable trends in certain key assumptions used in measuring our potential asbestos exposure to pending claims and those estimated to be filed over the next 10 years. The following table provides further information by expense type, as well as a breakdown of operating expense by segment.

	2010	2009	CHANGE
Sales and marketing expenses	$166	$149	11.4%
General and administrative expenses	176	201	(12.4)%
Research and development expenses	61	53	15.1%
Restructuring and asset impairment charges, net	3	43	(93.0)%
Asbestos-related costs, net	385	238	61.8%
Total operating expenses	$791	$684	15.6%
By Segment:			
Industrial Process	$137	154	(11.0)%
Motion Technologies	68	85	(20.0)%
Interconnect Solutions	105	89	18.0%
Control Technologies	66	63	4.8%
Corporate & Other	415	293	41.6%

The increase in sales and marketing expenses was primarily due to additional variable selling costs corresponding to the rise in revenues. Additional factors contributing to the increased costs include added headcount in emerging market locations and higher employee related costs within the ICS segment primarily due to increased commissions and severance costs.

The decrease in G&A expenses was primarily due to lower costs for corporate compensation and benefit related matters. G&A expenses were relatively flat within our operating segments, as a $15 decline at Industrial Process was offset by a $12 increase at ICS. The decline at Industrial Process was primarily due to lower bad debt expense while the increase at

ICS was primarily due to increased compensation costs and bad debt expense.

The increased R&D expense is primarily due to additional development projects within the ICS segment, such as our Universal Connector and Elec tric Vehicle Connector.

During 2010, we recognized net restructuring charges of $3, representing a $40 decrease as compared to the prior year. This decrease in expense was mainly attributable to a fewer number of actions that were initiated during 2010 versus 2009. Restructuring charges incurred during 2009 related to the relocation of certain Motion Technologies and ICS production facilities to lower cost regions. See Note 6, "Restructuring and Asset Impairment Charges," to the Consolidated Financial Statements for additional information.

Asbestos-Related Costs, Net

For the years ended December 31, 2010 and 2009, the income statement effects to continuing operations from asbestos charges consisted of the following:

	December 31, 2010			December 31, 2009		
	Liability	Asset	Net	Liability	Asset	Net
Provision	$ 67	$ 12	$ 55	$ 56	$ 28	$ 28
Remeasurement	524	194	330	644	434	210
Asbestos-related costs before tax	591	206	385	$700	$462	238
Tax benefit			(144)			(95)
Asbestos-related costs, net of tax			$ 241			$143

Charges included in the table above reflect undiscounted costs that the Company is estimated to incur to resolve all pending claims, as well as unasserted claims estimated to be filed over the next 10 years, including legal fees.

In the third quarter of 2009, we recorded a charge for claims estimated to be filed against the Company over the next 10 years for the first time. Beginning in the fourth quarter of 2009, we began recording a quarterly Provision to maintain a rolling 10 year projection period. The increase in the net Provision expense from 2009 to 2010 is a result of the Provision in 2009 including only the fourth quarter of 2009, while the Provision in 2010 includes a quarterly expense for all four quarters in 2010. The increase in our net Remeasurement expense from 2009 to 2010 was a result of several developments, including higher settlement costs and significantly increased activity in several higher-cost jurisdictions, increasing the number of cases to be adjudicated and the expected legal costs.

See Note 20, "Commitments & Contingencies," to the Consolidated Financial Statements for further information on our asbestos-related liability and assets.

OPERATING LOSS

Our 2010 and 2009 results include operating losses of $184 and $121, respectively, due to asbestos-related costs of $385 and $238 discussed above and in Note 20, "Commitments and Contingencies", to the Consolidated Financial Statements. Asbestos-related costs reduced operating margins by 2,020 basis points and 1,340 basis points in 2010 and 2009, respectively. Operating margin during 2010 was favorably impacted by lower restructuring and asset impairment costs of $40 which provided a 230 basis point improvement and net cost reductions of $42 which provided a 240 basis point improvement. Net cost reductions were the result of global sourcing initiatives, Value-Based Six Sigma and prior restructuring actions, which more than offset the impact from rising material, labor and overhead costs. The following table illustrates the 2010 and 2009 operating income (loss) results of our segments, including operating margin results.

	2010	2009	CHANGE
Industrial Process	$ 79	$ 72	9.7%
Motion Technologies	85	48	77.1%
Interconnect Solutions	37	19	94.7%
Control Technologies	29	32	(9.4)%
Segment operating income	230	171	34.5%
Asbestos-related costs, net	(385)	(238)	61.8%
Other corporate costs	(29)	(54)	(46.3)%
Total operating loss	(184)	(121)	52.1%
Operating margin:			
Consolidated operating margin	(9.6)%	(6.8)%	(280)bp
Segment operating margin	12.1%	9.7%	240bp
Industrial Process	11.4%	10.0%	140bp
Motion Technologies	15.5%	9.8%	570bp
Interconnect Solutions	9.0%	5.6%	340bp
Control Technologies	10.5%	13.2%	(270)bp

Industrial Process' operating income increased $7 or 9.7% during 2010, resulting in an operating margin of 11.4%, an improvement of 140 basis points versus 2009. The year-over-year growth was primarily attributable to lower bad debt and restructuring costs, as well as benefits from sourcing and productivity initiatives. These positive factors were partially offset by lower sales and increased emerging market investments.

Motion Technologies' operating income increased $37 or 77.1% during 2010, resulting in an operating margin of 15.5%, an improvement of 570 basis points versus 2009. The year-over-year growth was primarily attributable to lower restructuring costs, increased sales volumes and benefits from productivity initiatives. Global sourcing actions mitigated rising material costs.

Interconnect Solutions' operating income increased $18 or 94.7% during 2010, resulting in an operating margin of 9.0%, an improvement of 340 basis points versus 2009. The year-over-year growth was primarily attributable to increased sales volumes and lower restructuring costs, as well as benefits from sourcing and productivity initiatives. These positive factors were partially offset by increased R&D costs, bad debt expense and costs incurred in connection with a sales department reorganization initiative.

Control Technologies' operating income decreased $3 or 9.4% during 2010, resulting in an operating margin of 10.5%, a decline of 270 basis points versus 2009. The year-over-year decline was primarily attributable to a $5 unfavorable 2010 inventory adjustment, which was partially offset by increased sales volumes and benefits from sourcing and productivity initiatives.

Other corporate costs declined $25, or 46.3%, during 2010 primarily due to a $15 decline in employee compensation and benefit costs and a $6 decline from additional 2009 product liability related costs.

INTEREST AND NON-OPERATING EXPENSES, NET

	2010	2009	CHANGE
Interest expense	$97	$98	(1.0)%
Interest income	11	17	(35.3)%
Miscellaneous (income) expense, net	6	6	–
Total interest and non-operating expenses, net	92	87	5.7%

Interest expense for 2010 was relatively flat as compared to 2009, as a reduction in interest expense derived from commercial paper of $20 was offset by an increase in interest expense from long-term debt related to the issuance of $1 billion of debt in May 2009. Our daily average outstanding commercial paper balance decreased from $704 in 2009 to $231 in 2010. The decline in 2010 interest income was primarily due to the recognition of a $13 interest refund received in conjunction with an U.S federal tax settlement during 2009.

INCOME TAX BENEFIT

During the year ended December 31, 2010, we recognized an income tax benefit of $144 on a loss from continuing operations before income taxes of $276, an effective rate of 52.2%, as compared to an income tax benefit of $97 on a loss from continuing operations before income taxes of $208, an effective rate of 46.6%, in the prior year.

The year-over-year decrease in the effective tax rate was partially attributable to an income tax benefit in 2010 from the release of a valuation allowance. The sale of CAS in 2010 enabled us to utilize a previously reserved capital loss carryforward, which benefited the 2010 effective tax rate by $36, or 12.9%. The effective tax rate was also impacted by $35 of tax credits. These 2010 benefits to the effective tax rate were partially offset by the enactment of the Patient Protection Act of 2010 which resulted in the write-off of a deferred tax asset of $12, and increased the effective tax rate by 4.2%. These 2010 income tax benefits largely replaced the prior year benefit of $14 from the release of a valuation allowance for state deferred tax assets which benefited the effective tax rate by 6.6%.

INCOME FROM DISCONTINUED OPERATIONS, NET OF TAX

Income from discontinued operations, net of tax, was $936 for 2010, as compared to $740 for 2009. These results primarily reflect the operations of Exelis and Xylem, which were discontinued in connection with the Distribution. The results also reflect the recognition of an after-tax gain on sale of $129 related to our divesture of CAS, a component of our former Defense segment, which was sold on September 8, 2010.

LIQUIDITY AND CAPITAL RESOURCES

Funding and Liquidity Strategy

Our funding needs are monitored and strategies are executed to meet overall liquidity requirements, including the management of our capital structure on both a short- and long-term basis. Historically, we have generated operating cash flow sufficient to fund our working capital, dividends, capital expenditures and financing requirements. Subsequent to the Distribution, while our ability to forecast future cash flows is more limited, we expect to fund our ongoing working capital, dividends, capital expenditures and financing requirements through cash flows from operations and cash on hand, accessing the commercial paper market and utilizing our borrowing capacity under the 2011 Revolving Credit Agreement, described below. If our access to the commercial paper market were adversely affected, we believe that alternative sources of liquidity, including our 2011 Revolving Credit Agreement would be sufficient to meet our short-term funding requirements.

In connection with the Distribution, ITT received a net cash transfer (the Contribution) of $729 and $857 from Exelis and Xylem, respectively. The proceeds from the Contribution were utilized during October 2011 to repay substantially all outstanding ITT long-term debt and commercial paper, with the remainder to be used for general corporate purposes, including Transformation costs.

Cash and cash equivalents at December 31, 2011 were 235.0% higher than the December 31, 2010 balance, and represented 18.8% of total assets. The increase in cash and cash equivalents is due largely to the Contribution. Cash and cash equivalents denominated in the Euro accounted for 67% of our cash and cash equivalents at of December 31, 2011.

We manage our worldwide cash requirements considering available funds among the many subsidiaries through which we conduct business and the cost effectiveness with which those funds can be accessed. We continue to look for opportunities to access cash balances in excess of local operating requirements to meet global liquidity needs in a cost-efficient manner. We have and may continue to transfer cash from certain international subsidiaries to the United States. and other international subsidiaries when it is cost effective to do so. Our intent is generally to indefinitely reinvest these funds outside of the United States; however, in connection with the Distribution we reviewed our domestic and foreign cash profile, expected future cash generation and investment opportunities and determined that $515 of previously undistributed foreign earnings would no longer be considered indefinitely reinvested outside the United States. Such undistributed foreign earnings have not been remitted to the United States and the timing of such remittance if any is currently under evaluation. In connection with the review of our domestic and foreign cash profile, we recorded $69 of income tax expense and a corresponding deferred tax liability in the fourth quarter of 2011.

In future periods, we expect to analyze any undistributed foreign earnings and profits for which an applicable outside basis difference exists to continue to support our assertion that such amounts will be indefinitely reinvested outside the United States. For the foreseeable future, ITT plans to reinvest the excess undistributed foreign earnings in its international operations, consistent with its overall intentions to support growth and expand in markets outside the U.S., particularly in China, Latin and South America, Eastern Europe, India, Africa and the Middle East, as well as other developing and emerging markets, through development of business segment products, increasing non-US capital spending, and potentially acquiring foreign businesses.

The amount and timing of dividends payable on our common stock are within the sole discretion of our Board of Directors and will be based on, and affected by, a number of factors, including our financial position and results of operations, available cash, expected capital spending plans, prevailing business conditions, and other factors the Board deems relevant. Therefore, there can be no assurance as to what level of dividends, if any, will be paid in the future. Aggregate dividends paid in 2011 were $193, compared to $176 in 2010 and $148 in 2009. After giving effect to the 1:2 Reverse Stock Split, we declared dividends of $0.50 per share of common stock in each of the four quarters of 2010 and the first three quarters of 2011, respectively. In connection with the fourth quarter dividends expected to be declared by Exelis and Xylem of $0.2066 per share and $0.2024 per share, respectively, ITT decreased its quarterly dividend from $0.50 per share to $0.091 per share. Accordingly, dividends expected to be declared in the fourth-quarter for the three companies in the aggregate equaled ITT's prior quarterly dividend of $0.50 per share. In the first quarter of 2012, we declared a dividend of $0.091 per share for shareholders of record on March 7, 2012. If dividends are declared each quarter of 2012 at a rate of $0.091 per share, aggregate dividends for 2012 would be approximately $35.

Significant factors that affect our overall management of liquidity include our credit ratings, the adequacy of commercial paper and supporting bank lines of credit, and the ability to attract long-term capital on satisfactory terms. We assess these factors along with current market conditions on a continuous basis, and as a result, may alter the mix of our short- and long-term financing when it is advantageous to do so.

We access the commercial paper market to supplement the cash flows generated internally to provide additional short-term funding for strategic investments and other non-recurring funding requirements. We manage our short-term liquidity through the use of our commercial paper program by adjusting the level of commercial paper borrowings as opportunities to deploy additional capital arise, it is cost effective to do so, and a sufficient return on investment can be generated.

Credit Facilities

Effective October 31, 2011 we replaced a three-year revolving $1.5 billion credit agreement (August 2010 Credit Facility) with a new four-year revolving $500 credit agreement (the 2011 Revolving Credit Agreement). The 2011 Revolving Credit Agreement is intended to provide access to additional liquidity and be a source of funding for the commercial paper program, if needed. Our policy is to maintain unused committed bank lines of credit in an amount greater than outstanding commercial paper balances. The interest rate for borrowings under the 2011 Revolving Credit Agreement is generally based on the London Interbank Offered Rate (LIBOR), plus a spread, which reflects our debt rating. The provisions of the 2011

Revolving Credit Agreement require that we maintain an interest coverage ratio, as defined, of at least 3.0 times and a leverage ratio, as defined, of not more than 3.0 times. At December 31, 2011, our interest coverage ratio and leverage ratio were well in excess of the minimum requirements. See Note 16 to the Consolidated Financial Statements for further information on the credit facility.

Our credit ratings as of December 31, 2011 are as follows:

Rating Agency	Short-Term Ratings	Long-Term Ratings
Standard & Poor's	A-3	BBB-
Moody's Investors Service	P-3	Baa3
Fitch Ratings	F2	A -

Please refer to the rating agency websites and press releases for more information.

Asbestos

Based on the estimated asbestos liability as of December 31, 2011 (for claims filed or estimated to be filed through 2021), we have estimated that we will be able to recover 57% of the asbestos indemnity and defense costs for pending claims as well as unasserted claims estimated to be filed over the next 10 years from our insurers or other responsible parties. However, there is uncertainty in estimating when cash payments related to the recorded asbestos liability will be fully expended and such cash payments will continue for a number of years past 2021 due to the significant proportion of future claims included in the estimated asbestos liability and the lag time between the date a claim is filed and when it is resolved. In addition, because there are gaps in our insurance coverage, reflecting uninsured periods, the insolvency of certain insurers and prior insurance settlements, and our expectation that certain policies from some of our primary insurers will exhaust within the next 10 years, actual insurance reimbursements vary from period to period and the anticipated recovery rate is expected to decline over time. Future recoverability rates may be impacted by other factors, such as future insurance settlements, unforeseen insolvencies and judicial determinations relevant to our coverage program, which are difficult to predict and subject to a high degree of uncertainty.

Subject to these inherent uncertainties, it is expected that future annual cash payments, net of recoveries related to pending asbestos claims and unasserted claims estimated to be filed within the next 10 years, will extend through approximately 2026 due to the length of time between the filing of a claim and its resolution. Certain of our primary coverage in place agreements are expected to exhaust in the next twelve months, which will result in higher net cash outflows for the short-term. These annual net cash outflows are projected to average $10 to $20, net of tax benefits over the next five years, as compared to an average of approximately $6, net of tax benefits in the past three years, and increase to an average of approximately $35 to $45, net of tax benefits over the remainder of the projection period. Recovery rates for the tenth year of our model are currently projected to be approximately 27% of cash spent on settlements and defense costs.

In light of the uncertainties and variables inherent in the long-term projection of the Company's asbestos exposures and potential recoveries, although it is probable that the Company will incur additional costs for asbestos claims filed beyond the next 10 years, we do not believe there is a reasonable basis for estimating the number of future claims, the nature of future claims, or the cost to resolve future claims for years beyond the next 10 years at this time. Accordingly, no liability or related asset has been recorded for any costs which may be incurred for claims asserted subsequent to 2021.

Due to these uncertainties, as well as our inability to reasonably estimate any additional asbestos liability for claims which may be filed beyond the next 10 years, it is not possible to predict the ultimate outcome of the cost of resolving the pending and estimated unasserted asbestos claims. We believe it is possible that the future events affecting the key factors and other variables within the next 10 years, as well as the cost of asbestos claims filed beyond the next 10 years, net of expected recoveries, could have a material adverse effect on our financial position, results of operations and cash flows.

Sources and Uses of Liquidity

Our principal source of liquidity is our cash flow generated from operating activities, which provides us with the ability to meet the majority of our short-term funding requirements. The following table summarizes net cash derived from operating, investing, and financing activities, as well as net cash derived from discontinued operations, for each of the three years ended December 31, 2011.

	2011	2010	2009
Operating Activities	**$ (323)**	$ (77)	$ 261
Investing Activities	**(107)**	(136)	(86)
Financing Activities	**1,202**	450	(497)
Foreign Exchange	**(9)**	(22)	34
Total net cash flow from continuing operations	**763**	215	(288)
Net cash from discontinued operations	**(279)**	(196)	272
Net change in cash and cash equivalents	**$ 484**	$ 19	$ (16)

Net cash used by operating activities was ($323) in 2011 representing a decrease of $246 from 2010. The decrease in operating cash flow was primarily attributable to several factors, the most significant of which are to a) $355 of cash payments associated with the Distribution, b) lower income from continuing operations of $446 as a result of $396 of Transformation costs and a higher deferred income tax expense of $414, partially offset by lower net asbestos-related costs of $285, c) a cash use associated with changes in working capital of $151, primarily related to changes in the level of trade receivables and accounts payable, and d) a cash benefit from lower accrued income taxes of $160. Net cash payments for asbestos matters in 2011 increased by $21 and contributions to our global postretirement benefit plans increased by $16, while cash payments for restructuring actions decreased by $20.

The annual net cash outflows associated with our asbestos-related liability are projected to average $10 to $20, net of tax, over the next five years, as compared to an average of approximately $6, net of tax, in the past three years, and increase to an average of approximately $35 to $45, net of tax, over the remainder of the projection period. We do not believe, subject to risks and uncertainties inherent in the estimation process, cash flows associated with the net asbestos-related liability for pending and unasserted claims estimated to be filed over the next 10 years will materially affect our short- or long-term liquidity or our operating cash flow.

Net cash used by operating activities was ($77) in 2010, a decrease of $338 as compared to 2009. Significant contributing factors included a) a decrease in operating income from continuing operations of $21 as improved operating performance by the segments was offset by higher net asbestos-related costs of $147, b) a cash benefit from changes in working capital of $63, primarily related to accounts payable which was supporting higher inventory levels, and c) a cash use associated with higher accrued income taxes of $354. Compared to 2009, net cash payments for asbestos matters in 2010 decreased by $7 and contributions to our global postretirement benefit plans increased by $7.

Net cash used in investing activities decreased by $29 in 2011 as compared to 2010. Spending on capital expenditures decreased by $24 as a result of a decision to terminate the planned implementation of an entity-wide enterprise resource planning (ERP) system in early 2011 for which we had capital expenditures of $35 in 2010. The ERP implementation was terminated in 2011 and $55 of capitalized costs were written off as part of Transformation costs included in continuing operations.

Net cash used in investing activities increased by $50 in 2010 as compared to 2009 as we increased our capital expenditure spending by $29, primarily related to the implementation of an entity-wide ERP system and a net cash use in 2010 of $10, net of cash acquired, for the acquisition of Canberra.

Net cash provided by financing activities increased by $752 in 2011 as compared to 2010, primarily related to the $1,586 Contribution paid to ITT by Exelis and Xylem in connection with the Distribution, lower cash used by Xylem for acquisitions and the net effect of the global cash pooling in which Exelis and Xylem participated prior to the Distribution. The proceeds received by ITT from the Contribution were used during October 2011 to repay substantially all outstanding ITT long-term debt, commercial paper and capital leases, as well as debt extinguishment costs of $297 and other cash Transformation costs. Cash provided by financing activities in 2011 also included a cash inflow of $53 from the exercise of employee stock options, an increase of $25 compared to 2010 and cash outflow of $193 related to cash dividend payments, a 9.7% increase over 2010.

Compared to 2009, our 2010 cash flow from financing activities increased $947. In 2010, we repaid $135 of short and long-term debt compared to 2009 repayments of $644, net of $1 billion of debt issued in May 2009, primarily related to the financing of Exelis' EDO acquisition and our acquisition of IMC, both in 2007. Financing cash flows also benefitted from the net effect of the global cash pooling in which Exelis and Xylem participated prior to the Distributions, offset in part by increased cash used by Xylem for acquisitions. Our cash usage related to financing activities during 2010 also included $176 of dividend payments that represented an 18.9% increase as compared to 2009.

Our average daily outstanding commercial paper balance for the year ended 2011 and 2010 was $128 and $231, respectively. The maximum outstanding commercial paper during 2011 and 2010 was $408 and $620, corresponding with Xylem's acquisition of YSI in 2011 and Godwin in 2010. As of December 31, 2011, we did not have any commercial paper outstanding.

During the first half of 2012, we expect to receive a $105 refund from the U.S. Internal Revenue Service (IRS) for income taxes previously paid. In addition, we expect to receive an additional $35 income tax refund near the end of 2012 for net operating losses and R&D tax credits generated during 2011 and $25 for carryback of foreign credits to prior years. Under the Tax Matters Agreement, $27 of the $35 refund is owed to Exelis.

Funding of Postretirement Plans

Effective as of the Distribution Date, ITT transferred to Exelis and Xylem certain defined benefit pension and other postretirement benefit plans, most significantly the U.S. Salaried Retirement Plan to Exelis. Following the distribution, Exelis and Xylem assumed all liabilities and assets associated with such plans and became the plans' sponsors.

The net liabilities associated with such plans assumed by Exelis and Xylem were approximately $2,150 and $170, respectively, excluding net deferred tax assets of approximately $800 and $55, respectively.

At December 31, 2011, our global postretirement benefit plans were underfunded by $330, of which $146 relates to pension plans, including $50 for non-U.S. plans which are typically not funded due to local regulations, and $184 relates to other postretirement benefit plans. Funding requirements under IRS rules are a major consideration in making contributions to our U.S. postretirement benefit plans. With respect to U.S. qualified postretirement benefit plans, we intend to contribute annually not less than the minimum required by applicable law and regulations. During 2011, we contributed $27 to our U.S. postretirement benefit plans, $18 of which was to U.S. pension plans and $9 to our other employee-related benefit plans.

While the Company has significant discretion in making voluntary contributions, the Employee Retirement Income Security Act of 1974, as amended by the Pension Protection Act of 2006 and further amended by the Worker, Retiree, and Employer Recovery Act of 2008 and applicable Internal Revenue Code regulations mandate minimum funding thresholds. Failure to satisfy the minimum funding thresholds could result in restrictions on our ability to amend the plan or make benefit payments. In general, certain benefit restrictions apply when the Adjusted Funding Target Attainment Percentage (AFTAP) of a plan is less than 80%. When the AFTAP is between 80% and 60%, there is a restriction on plan amendments and a partial restriction on accelerated benefit payments (i.e., lump sums cannot exceed 50% of the value of the participants total benefit). Full benefit restrictions apply if the plan's AFTAP falls below 60%. Although mandatory contributions to our U.S. postretirement plans were not required during 2011, we will continue to monitor the funded status and minimum funding requirements.

The funded status at January 1, 2012 and future statutory minimum contributions will depend primarily on the return on assets and discount rate, both determined using AFTAP guidelines. Depending on these factors, and the resulting funded status of our U.S. pension plans, the level of future statutory minimum contributions could be material. We currently anticipate making contributions of $20 to $25 to our global pension plans during 2012.

Capital Resources

Long-term debt is raised through the offering of debt securities primarily within the United States capital markets. Long-term debt is generally defined as any debt with an original maturity greater than 12 months. On September 20, 2011, Exelis and Xylem issued an aggregate principal of $1,850 of long-term debt. The Exelis and Xylem Notes were initially guaranteed on a senior unsecured basis by ITT. The guarantee terminated and was automatically and unconditionally released on the distribution of the common stock of Exelis and Xylem to the holders of the Company's common stock.

In October 2011, we paid $1,340 and deposited U.S. Treasury securities with an aggregate purchase price of $263 to retire $1,251 of long-term debt that was outstanding as of September 30, 2011. Additionally during 2011, we terminated a sale leaseback agreement by repurchasing the leased property for $66. These transactions resulted in a net $297 charge presented within our Consolidated Income Statement as Transformation costs.

As of December 31, 2011, we have sources of long- and short-term funding including access to the capital markets through an unlimited 2009 Shelf Registration Statement, an available $500 commercial paper program and unused credit lines. Our commercial paper program is supported by the 2011 Revolving Credit Agreement.

We had the following long-term debt outstanding at December 31:

	2011	2010
Current portion of long-term debt	**$2**	$ 10
Non-current portion of long-term debt	**4**	1,350
Total long-term debt	**$6**	$1,360

See further details on debt transactions in 2011 in Note 16, "Debt," to the Consolidated Financial Statements.

Contractual Obligations

ITT's commitment to make future payments under long-term contractual obligations was as follows, as of December 31, 2011:

	PAYMENTS DUE BY PERIOD				
CONTRACTUAL OBLIGATIONS	TOTAL	LESS THAN 1 YEAR	1-3 YEARS	3-5 YEARS	MORE THAN 5 YEARS
Debt	$ 6	$ 2	$ 1	$ 1	$ 2
Operating leases	134	17	22	18	77
Purchase obligations(1)	113	86	26	–	–
Other long-term obligations(2)	141	23	39	36	43
Total	$394	$128	$88	$55	$122

In addition to the amounts presented in the table above, we have recorded liabilities for pending asbestos claims and asbestos claims estimated to be filed over the next ten years and uncertain tax positions of $1,668 and $100, respectively, in our Consolidated Balance Sheet at December 31, 2011. These amounts have been excluded from the contractual obligations table due to an inability to reasonably estimate the timing of payments in individual years.

(1) Represents unconditional purchase agreements that are enforceable and legally binding and that specify all significant terms to purchase goods or services, including fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the approximate timing of the transaction. Purchase agreements that are cancellable without penalty have been excluded.

(2) Other long-term obligations include amounts recorded on our December 31, 2011 Consolidated Balance Sheet, including estimated environmental payments and employee compensation agreements. We estimate, based on historical experience that we will spend between $12 and $15 per year on environmental investigation and remediation. We are contractually required to spend a portion of these monies based on existing agreements with various governmental agencies and other entities. At December 31, 2011, our recorded environmental liability was $102.

Off-Balance Sheet Arrangements

Off-balance sheet arrangements represent transactions, agreements or other contractual arrangements with unconsolidated entities, where an obligation or contingent interest exists. Our off-balance sheet arrangements, as of December 31, 2011, consist of indemnities related to acquisition and disposition agreements and certain third-party guarantees.

Indemnities

As part of the Distribution, ITT provided certain indemnifications and cross-indemnifications among ITT, Exelis and Xylem, subject to limited exceptions with respect to employee claims. The indemnifications address a variety of subjects, including asserted and unasserted product liability matters (e.g., asbestos claims, product warranties) which relate to products manufactured, repaired and/or sold prior to the Distribution Date. The indemnifications are indefinite. The indemnification associated with pending and future asbestos claims does not expire. In addition, ITT, Exelis and Xylem agreed to certain cross-indemnifications with respect to other liabilities and obligations. ITT expects Exelis and Xylem to fully perform under the terms of the Distribution Agreement and therefore has not recorded a liability for matters for which we have been indemnified. In addition, we are not aware of any claims or other circumstances that would give rise to material payments to Xylem or Exelis under the indemnity provided by ITT.

Since ITT's incorporation in 1920, we have acquired and disposed of numerous entities. The related acquisition and disposition agreements contain various representation and warranty clauses and may provide indemnities for a misrepresentation or breach of the representations and warranties by either party. The indemnities address a variety of subjects; the term and monetary amounts of each such indemnity are defined in the specific agreements and may be affected by various conditions and external factors. Many of the indemnities have expired either by operation of law or as a result of the terms of the agreement. We do not have a liability recorded for these indemnifications and are not aware of any claims or other information that would give rise to material payments under such indemnities.

Guarantees

We have a number of guarantees, letters of credit and similar arrangements outstanding at December 31, 2011 primarily pertaining to commercial or performance guarantees and insurance matters. We have not recorded any loss contingencies under these guarantees, letters of credit and similar arrangements as of December 31, 2011 as the likelihood of nonperformance by the underlying obligors is considered remote. From time to time, we may provide certain third-party guarantees that may be affected by various conditions and external factors, some of which could require that payments be made under such guarantees. We do not consider the maximum exposure or current recorded liabilities under our third-party guarantees to be material either individually or in the aggregate. We do not believe such payments would have a material adverse impact on our financial position, results of operations or cash flows on a consolidated basis.

In December 2007, we entered into a sale leaseback agreement for our corporate aircraft, with the aircraft leased to ITT under a five-year operating lease and ITT provided a residual value guarantee to the lessor for the future value of the aircraft. During the second quarter of 2011, we purchased the aircraft from the lessor for $50, the price stated in the sale leaseback agreement, and as such the sale leaseback agreement and the associated residual value guarantee were terminated. In connection with this transaction, we settled a previously recorded $22 residual value guarantee and recognized an additional charge of $3, presented within G&A expenses, as the purchase price exceeded the fair value of the aircraft at the date of termination of the sale leaseback agreement. One of the corporate aircraft was sold for a gain of $3 and the other aircraft was distributed to Exelis, and accordingly, at December 31, 2011, ITT no longer owned any corporate aircraft.

In December 2011, the Flagler County Board of Commissioners approved the termination of certain construction obligations associated with a 1984 Development Order for Development of Regional Impact ("DRI") known as Hammock Dunes, Florida. On February 1, 2012, the Flagler County Board of Commissioners released ITT from further material obligations related to the DRI and cancelled the $10 bond issued in its favor by ITT to secure the construction obligations under the DRI. As a result of the approval to terminate the construction obligation in December 2011, the Company released its $10 previously recorded contingent liability for these construction obligations.

Critical Accounting Estimates

The preparation of financial statements and related disclosures in accordance with GAAP requires us to make judgments, estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Significant accounting policies used in the preparation of the financial statements are discussed in Note 1, "Summary of Significant Accounting Policies," to the Consolidated Financial Statements. An accounting policy is deemed critical if it requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time the estimate is made, if different estimates reasonably could have been used, or if changes to the estimate that are reasonably possible could materially affect the financial statements. Senior management has discussed the development, selection and disclosure of these estimates with the Audit Committee of ITT's Board of Directors.

The accounting estimates and assumptions discussed below are those that we consider most critical to fully understanding our financial statements and evaluating our results as they are inherently uncertain, involve the most subjective or complex judgments, include areas where different estimates reasonably could have been used, and the use of an alternative estimate that is reasonably possible could materially effect the financial statements. We base our estimates on historical experience and other data and assumptions believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Management believes that the accounting estimates employed and the resulting balances reported in the Consolidated Financial Statements are reasonable; however, actual results could differ materially from our estimates and assumptions.

Asbestos Matters

ITT, including its subsidiary Goulds Pumps, Inc., has been joined as a defendant with numerous other companies in product liability lawsuits alleging personal injury due to asbestos exposure. These claims allege that certain products sold by us or our subsidiaries prior to 1985 contained a part manufactured by a third party (e.g., a gasket) which contained asbestos. To the extent these third-party parts may have contained asbestos, it was encapsulated in the gasket (or other) material and was non-friable. In certain other cases, it is alleged that former ITT companies were distributors for other manufacturers' products that may have contained asbestos.

Estimating our exposure to pending asbestos claims and those that may be filed in the future is subject to significant uncertainty and risk as there are multiple variables that can affect the timing, severity, quality, quantity and resolution of claims. The methodology used to project future asbestos costs is based largely on the Company's experience in a reference period, including the last few years, for claims filed, settled and dismissed, and is supplemented by management's expectations of the future. This experience is compared to the results of previously conducted epidemiological studies by estimating the number of individuals likely to develop asbestos-related diseases. Those studies were undertaken in connection with an independent analysis of the population of U.S. workers across eleven different industry and occupation categories believed to have been exposed to asbestos. Using information for the industry and occupation categories relevant to the Company, an estimate is developed of the number of claims estimated to be filed against the Company over the next ten years, as well as the aggregate settlement costs that would be incurred to resolve both pending and estimated future claims based on the average settlement costs by disease during the reference period. In addition, the estimate is augmented for the costs of defending asbestos claims in the tort system using a forecast based on recent experience, as well as discussions with the Company's external defense counsel. The asbestos liability has not been discounted to present value due to the inability to reliably forecast the timing of future cash flows. The Company retains a consulting firm to assist management in estimating our potential exposure to pending asbestos claims and for claims estimated to be filed over the next 10 years. The methodology to project future asbestos costs is one in which the underlying assumptions are separately assessed for their reasonableness and then each is used as an input to the liability estimate. Our assessment of the underlying assumptions yields only one value for each assumption.

The liability estimate is most sensitive to assumptions surrounding mesothelioma and lung cancer claims, as together, the estimated costs to resolve pending and estimated future mesothelioma and lung cancer claims represent more than 90% of the estimated asbestos exposure, but only 10% of pending claims. The assumptions related to mesothelioma and lung cancer that are most significant include the number of new claims forecast to be filed against the Company in the future, the projected average settlement costs (including the rate of inflation assumed), the percentage of claims against the Company that are dismissed without a settlement payment, and the cost to defend against filed claims.

These assumptions are interdependent, and no one factor predominates in estimating the asbestos liability. While there are other potential inputs to the model used to estimate our asbestos exposures for pending and estimated future claims, our methodology relies on the best input available in the circumstances for each individual assumption and does not create a range of reasonably possible outcomes. Projecting future asbestos costs is subject to numerous variables and uncertainties that are inherently difficult to predict. In addition to the uncertainties surrounding the key assumptions, additional uncertainty related to asbestos claims arises from the long latency period prior to the manifestation of an asbestos-related disease, changes in available medical treatments and changes in medical costs, changes in plaintiff behavior resulting from bankruptcies of other companies that are potential or co-defendants, uncertainties surrounding the litigation process from jurisdiction to jurisdiction and from case to case, and the impact of potential legislative or judicial changes.

The forecast period used to estimate our potential exposure to pending and projected asbestos claims is a judgment based on a number of factors, including the number and type of claims filed, recent experience with pending claims activity and whether that experience will continue into the future, the jurisdictions where claims are filed, the effect of any legislative or judicial developments, and the likelihood of any comprehensive asbestos legislation at the federal level. These factors have both positive and negative effects on the dynamics of asbestos litigation in the tort system and, accordingly, our estimate of the asbestos exposure. Developments related to asbestos tend to be long-cycle, changing over multi-year periods. Accordingly, we monitor these and other factors and periodically assess whether an alternative forecast period is appropriate.

We record a corresponding asbestos-related asset that represents our best estimate of probable recoveries related to the recorded asbestos liability. In developing this estimate, the Company considers coverage-in-place and other settlement agreements with its insurers and other contractual agreements with responsible parties, as well as a number of additional factors. These additional factors include expected levels of future cost recovery, the financial viability of the insurance companies or other responsible parties, the method by which losses will be allocated to the various insurance policies and the years covered by those policies, the extent to which settlement and defense costs will be reimbursed by the insurance policies, and interpretation of the various policy and contract terms and limits and their interrelationships. The asbestos-related asset has not been discounted to present value.

The Company has negotiated with certain of its excess insurers to reimburse the Company for a portion of its settlement and/or defense costs as incurred, frequently referred to as "coverage-in-place" agreements. Under coverage-in-place agreements, an insurer's policies remain in force and the insurer undertakes to provide coverage for the Company's present and future asbestos claims on specified terms and conditions that address, among other things, the share of asbestos claims costs to be paid by the insurer, payment terms, claims handling procedures and the expiration of the insurer's obligations. As of December 31, 2011, the Company has entered into five coverage-in-place agreements representing approximately 40% of our recorded asset. Certain of our primary coverage-in-place agreements are expected to exhaust in the next twelve months, which will result in higher net cash outflows for the short-term. The Company has entered into policy buyout and settlement agreements with certain insurers confirming the aggregate amount of available coverage under the subject policies and setting forth a schedule for future reimbursement payments to the Company based on aggregate indemnity and defense payments made by the Company. As of December 31, 2011, the Company has entered into two policy buyout and settlement agreements representing approximately 10% of our recorded asset, including an agreement in principal entered into in the fourth quarter of 2011 that will result in $68 million being paid to the Company between 2012 and 2026. In addition, the Company is party to a cost sharing agreement that represents 10% of our recorded asset. The cost sharing agreement provides that responsibility for costs associated with claims resolved gradually transitions away from ITT, such that ITT will have no responsibility for claims resolved beginning no later than July 1, 2022. While there are overall limits on the aggregate amount of insurance available to the Company with respect to asbestos claims, those overall limits were not reached by the estimated liability recorded by the Company at December 31, 2011. In the aggregate, approximately 60% of our asbestos-related asset represents coverage-in-place agreements, policy buyout settlements and other agreements with our insurers and other responsible parties.

The timing and amount of reimbursements from our insurers and other responsible parties will vary due to the lag between when ITT pays an amount to defend or settle a claim and when a reimbursement is received, differing policy terms, and certain gaps in our insurance coverage as a result of uninsured periods, insurer insolvencies, and prior insurance settlements.

The Company retains an insurance consulting firm to assist management in estimating probable recoveries for pending asbestos claims and for claims estimated to be filed over the next 10 years based on the analysis of policy terms, the likelihood of recovery provided by external legal counsel assuming the continued viability of those insurance carriers and other responsible parties that are currently solvent, incorporating risk mitigation judgments where policy terms or other factors are not certain, and allocating asbestos settlement and defense costs between our insurers and other responsible parties.

Using the estimated liability as of December 31, 2011 (for claims filed or estimated to be filed through 2021), we estimate that we will be able to recover approximately 57% of indemnity and defense costs for pending claims and unasserted claims estimated to be filed over the next 10 years from our insurers and other responsible parties. However, there is uncertainty in estimating when cash payments related to the recorded asbestos liability will be fully expended and such cash payments will continue for a number of years past 2021 due to the significant proportion of future claims included in the estimated asbestos liability and the lag time between the date a claim is filed and when it is resolved. In addition, because there are gaps in our insurance coverage and our expectation that certain policies from some of our primary insurers will exhaust within the next 10 years, actual insurance reimbursements vary from period to period and the anticipated recovery rate is expected to decline over time. Recovery rates for the tenth year of our model are currently projected to be approximately 27% of cash spent on settlements and defense costs. Future recovery rates may be impacted by other factors, such as future insurance settlements, insolvencies and judicial determinations relevant to our coverage program, which are difficult to predict and subject to a high degree of uncertainty.

Our estimated asbestos liability and related receivables are based on management's best estimate of future events largely based on past experience; however, past experience may not prove a reliable predictor of the future. Future events affecting the key assumptions and other variables for either the asbestos liability or the related receivables could cause actual costs and recoveries to be materially higher or lower than currently estimated. For example, a significant upward or downward trend in the number of claims filed, depending on the nature of the alleged injury, the jurisdiction where filed and the quality of the product identification, or a significant upward or downward trend in the costs of defending claims, could change the estimated liability, as would substantial adverse verdicts at trial that withstand appeal. A legislative solution, structured settlement transaction, or significant change in relevant case law could also change the estimated liability. Further, the bankruptcy of an insurer or other responsible party or settlements with our insurers, whether through coverage-in-place agreements or policy buyouts, could change the estimated receivable.

Furthermore, any predictions with respect to the variables impacting the estimate of the asbestos liability and related asset are subject to even greater uncertainty as the projection period lengthens. In light of the uncertainties and variables inherent in the long-term projection of the Company's asbestos exposures and potential recoveries, although it is probable that the Company will incur additional costs for asbestos claims filed beyond the next 10 years, we do not believe there is a reasonable basis for estimating the number of future claims, the nature of future claims, or the cost to resolve future claims for years beyond the next 10 years at this time. Accordingly, no accrual or receivable has been recorded for any costs which may be incurred for claims asserted subsequent to 2021.

Due to these uncertainties, as well as our inability to reasonably estimate any additional asbestos liability for claims which may be filed beyond the next 10 years, it is not possible to predict the ultimate outcome of the cost of resolving the pending and estimated unasserted asbestos claims. We believe it is possible that the future events affecting the key factors and other variables within the next 10 years, as well as the cost of asbestos claims filed beyond the next 10 years, net of expected recoveries, could have a material adverse effect on our financial position, results of operations and cash flows.

As part of our ongoing review of our estimated asbestos exposure and related receivables, each quarter we assess the most recent data available underlying the key assumptions related to mesothelioma and lung cancer (e.g., claims filed, settled and dismissed, acceptance rates, average settlement values), comparing the data to the expectations on which the most recent annual liability and asset estimates were based. In addition to evaluating ITT's claims experience, the Company also considers additional quantitative and qualitative factors such as significant appellate rulings and legislative developments, and their respective effects on estimated future filings and settlement values, and trends in the tort system. Our quarterly procedures also involve a review of our assumed recovery rates, considering changes in the financial wherewithal of the insurers and settlements or other agreements with insurers. Provided the quarterly review does not indicate a more detailed evaluation of our asbestos exposure is required, each quarter, we record a net asbestos expense to maintain a rolling 10-year time horizon. In the third quarter each year we conduct a detailed study with the assistance of outside consultants to review and update, as appropriate, the underlying assumptions used to estimate our asbestos liability and related assets, including a reassessment of the time horizon over which a reasonable estimate of unasserted claims can be projected.

Revenue Recognition

Revenue is derived from the sale of products and services to customers. We recognize revenue when persuasive evidence of an arrangement exists, the sales price is fixed or determinable, collectability is reasonably assured and delivery has occurred. For product sales, other than long-term construction and production-type contracts (referred to as design and build arrangements), we recognize revenue at the time title and risks and rewards of ownership pass to the customer, which is generally when products are shipped, and the contractual terms have been fulfilled. Certain contracts with customers require delivery, installation, testing, certification or other acceptance provisions to be satisfied before revenue is recognized. In instances where contractual terms include a provision for customer acceptance, revenue is recognized when either (i) we have previously demonstrated that the product meets the specified criteria based on either seller or customer-specified objective criteria or (ii) on formal acceptance received from the customer where the product has not been previously demonstrated to meet customer-specified objective criteria.

We recognize revenue on product sales to channel partners, including resellers, distributors or value-added solution providers at the time of sale when the channel partners have economic substance apart from ITT and ITT has completed its obligations related to the sale. Revenue on service and repair contracts is recognized after services have been agreed to by the customer and rendered or over the service period.

We enter into contracts to sell our products and services, and while the majority of our sales agreements contain standard terms and conditions, certain agreements contain multiple elements or non-standard terms and conditions. Where sales agreements contain multiple elements or non-standard terms and conditions, judgment is required to determine the appropriate accounting, including whether the deliverables specified in these agreements should be treated as separate units of accounting for revenue recognition purposes, and, if so, how the transaction price should be allocated among the elements and when to recognize revenue for each element.

When a sale involves multiple deliverables, the entire fee from the arrangement is allocated to each unit of accounting based on the relative selling price of the deliverable to all other deliverables in the contract. Revenue for multiple element arrangements is recognized when the appropriate revenue recognition criteria for the individual deliverable have been satisfied. The allocation of sales price between elements may impact the timing of revenue recognition, but will not change the total revenue recognized on the arrangement. For agreements that contain multiple deliverables, we recognize revenue based on the relative selling price if the deliverable has stand-alone value to the customer and, in arrangements that include a general right of return relative to the delivered element, performance of the undelivered element is considered probable and substantially in the Company's control. The selling price for a deliverable is based on vendor-specific objective evidence of selling price (VSOE), if available, third-party evidence of selling price (TPE), if VSOE is not available, or best estimated selling price (BESP), if neither VSOE nor TPE is available.

The deliverables in our arrangements with multiple elements include various products and may include related services, such as installation and start-up services. We allocate arrangement consideration based on the relative selling prices of the separate units of accounting determined in accordance with the hierarchy described above. For deliverables that are sold separately, we establish VSOE based on the price when the deliverable is sold separately. We establish TPE, generally for services, based on prices similarly situated customers pay for similar services from third party vendors. For those deliverables for which we are unable to establish VSOE or TPE, we estimate the selling price considering various factors including market and pricing trends, geography, product customization, and profit objectives.

We recognize revenue on certain design and build projects using the completed contract method. Provisions for estimated losses, if any, on uncompleted design and build arrangements, are recognized in the period in which such losses are determined. Due to the long-term nature of the contracts, these estimates are subject to uncertainties and require significant judgment and may consider historical performance, the complexity of the work to be performed, the estimated time to complete the project, and other economic factors such as inflation.

Additionally, accruals for estimated expenses related to sales returns and warranties are made at the time products are sold. Reserves for sales returns, rebates and other allowances are established using historical information on the frequency of returns for a particular product and period over which products can be returned. Future market conditions and product transitions may require us to take actions to increase customer incentive offerings, possibly resulting in a reduction in revenue at the time the incentive is offered.

For distributors and resellers, our typical return period is less than 180 days. Warranty accruals are established using historical information on the nature, frequency and average cost of warranty claims and estimates of future costs. Our standard product warranty terms generally include post-sales support and repairs or replacement of a product at no additional charge for a specified period of time. While we engage in extensive product quality programs and processes, we base our estimated warranty obligation on product warranty terms offered to customers, ongoing product failure rates, materials usage, service delivery costs incurred in correcting a product failure, as well as specific product class failures outside of our baseline experience and associated overhead costs. If actual product failure rates, repair rates or any other post-sales support costs differ from these estimates, revisions to the estimated warranty liability would be required.

Income Taxes

Deferred income tax assets and liabilities are determined based on the estimated future tax effects of differences between the financial reporting and tax bases of assets and liabilities, applying currently enacted tax rates in effect for the year in which we expect the differences will reverse. Based on the evaluation of available evidence, we recognize future tax benefits to the extent that we believe it is more likely than not we will realize these benefits. We periodically assess the likelihood that we will be able to recover our deferred tax assets and reflect any changes to our estimate of the amount we are more likely than not to realize in the valuation allowance, with a corresponding adjustment to earnings or other comprehensive income (loss), as appropriate.

Significant judgment is required in assessing the need for any valuation allowance recorded against deferred tax assets. In assessing the need for a valuation allowance, we consider all available evidence, including the future reversal of existing taxable temporary differences, taxable income in carryback periods, prudent and feasible tax planning strategies, and estimated future taxable income. The valuation allowance can be affected by changes to tax regulations, interpretations and rulings, changes to enacted statutory tax rates, and changes to future taxable income estimates.

The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income (including the reversals of deferred tax liabilities) during the periods in which those deferred tax assets will become deductible. The Company's management assesses available positive and negative evidence regarding the realizability of its deferred tax assets, and records a valuation allowance when it is more likely than not that all or a portion of the deferred tax assets will not be realized. To form a conclusion, management considers positive evidence in the form of reversing temporary differences, projections of future taxable income and tax planning strategies, and negative evidence such as recent history of losses. Beginning in 2011, the Company is in a cumulative three-year loss position, which we weighted as a significant source of negative evidence indicating the need for a valuation allowance on our net deferred tax assets. Since the Company was in a three-year cumulative loss position at the end of 2011, management determined that the size and frequency of the losses from continuing operations in recent years and the uncertainty associated with projecting future taxable income supported the conclusion that a valuation allowance was required to reduce its deferred tax assets. If ITT achieves profitability in future periods, then management will evaluate whether its recent history of profitability constitutes sufficient positive evidence to support a reversal of a portion, or all, of the remaining valuation allowance.

Our effective tax rate reflects the impact of certain undistributed foreign earnings for which we have not provided U.S. taxes because we plan to reinvest such earnings indefinitely outside the United States. We plan foreign earnings remittance amounts based on projected cash flow needs, as well as the working capital and long-term investment requirements of our foreign subsidiaries and our domestic operations. Based on these assumptions, we estimate the amount we will distribute to the United States and accrue U.S. federal taxes on these planned foreign remittance amounts. Material changes in our estimates of cash, working capital and long-term investment requirements in the various jurisdictions in which we do business could impact our effective tax rate. Our provision for income taxes could be adversely impacted by changes in our geographic mix of earnings or changes in the enacted tax rates in the jurisdictions in which we conduct our business.

The calculation of our deferred and other tax balances involves significant management judgment when dealing with uncertainties in the application of complex tax regulations and rulings in a multitude of taxing jurisdictions across our global operations. The Company is routinely audited by U.S federal, state and foreign tax authorities, the results of which could result in proposed assessments against the Company. We recognize potential liabilities and record tax liabilities for anticipated tax audit issues based on our estimate of whether, and to the extent to which, additional taxes will be due. Furthermore, we recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position in consideration of applicable tax statutes and related interpretations and precedents and the expected outcome of the proceedings (or negotiations) with the taxing authorities. Tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than 50% likelihood of being realized on ultimate settlement.

We adjust our liability for uncertain tax positions in light of changing facts and circumstances; however, the ultimate resolution of a tax examination may differ from the amounts recorded in the financial statements for a number of reasons, including the Company's decision to settle rather than litigate a matter, relevant legal precedent related to similar matters, and the Company's success in supporting its filing positions with the tax authorities. If our estimate of tax liabilities proves different than the ultimate outcome, such differences will effect the provision for income taxes in the period in which such determination is made.

Postretirement Plans

ITT sponsors numerous defined benefit pension and other postretirement benefit plans for certain employees around the world (collectively, postretirement benefit plans). Postretirement benefit obligations for domestic plans are generally determined on a flat dollar benefit formula and years of service. Foreign plan benefit obligations are primarily determined based on participant years of service, future compensation, and age at retirement or termination. The determination of projected benefit obligations and the recognition of expenses related to postretirement benefit plans are dependent on various assumptions that are judgmental and developed in consultation with our actuaries and other advisors. The major assumptions involved in the measurement of our postretirement benefit plan obligations and net periodic postretirement costs primarily relate to discount rates, long-term expected rates of return on plan assets, and mortality and termination rates. Actual results that differ from our assumptions are accumulated and are amortized generally over the estimated future working life of the plan participants.

Significant Assumptions

Management develops each assumption using relevant Company experience, in conjunction with market-related data for each individual country in which such plans exist. All assumptions are reviewed with external advisors and adjusted as necessary. The table included below provides the weighted average assumptions used to estimate our defined benefit pension obligations and costs as of and for the years ended 2011 and 2010.

	2011		2010	
	U.S.	**Int'l**	U.S.	Int'l
Obligation Assumptions:				
Discount rate	**4.79%**	**4.85%**	5.69%	5.03%
Cost Assumptions:				
Discount rate	**5.69%**	**5.03%**	6.00%	5.09%
Expected return on plan assets	**9.00%**	**4.75%**	9.00%	4.75%

The assumed discount rates reflect our expectation of the present value of expected future cash payments for benefits at the measurement date. A decrease in the discount rate increases the present value of benefit obligations and increases net periodic postretirement cost. We base the discount rate assumption on current investment yields of high-quality fixed income securities during the retirement benefits maturity period. The discount rates were determined by considering an interest rate yield curve comprising high quality corporate bonds, with maturities between zero and thirty years. Annual benefit payments are then discounted to present value using this yield curve to develop a single-point discount rate matching the plan's characteristics. Our weighted average discount rate for all postretirement benefit plan obligations, including foreign affiliate plans, at December 31, 2011 is 4.80%.

We determine our expected return on plan assets by evaluating both historical returns and estimates of future returns. Specifically, we estimate future returns based on independent estimates of asset class returns weighted by the targeted investment allocation and evaluate historical broad market returns over long-term timeframes based on our targeted asset allocation, which is detailed in Note 17, "Postretirement Benefit Plans," to the Consolidated Financial Statements. Based on this approach, our weighted average expected return on plan assets for all postretirement benefit plans, including foreign affiliate plans, at December 31, 2011 is 8.96%.

Prior to the Distribution of Exelis and Xylem, the Company's U.S. postretirement plans participated in a master trust that invested in asset classes that historically generated asset returns in excess of the expected long-term rate of return on plan assets. With the distribution of certain postretirement benefit plans and their respective plan assets to Exelis and

Xylem, we developed a new targeted asset allocation that is expected to generate a lower level of returns on plan assets than were realized in the past. Accordingly, we have reduced our long-term expected rate of return on plan assets beginning in 2012. For postretirement plans that participated in the master trust distributed to Exelis, the chart below shows actual returns compared to the expected long-term returns for our U.S. postretirement plans that were utilized in the calculation of the net periodic postretirement cost for each respective year.

	2011	2010	2009
Expected long-term rate of return on plan assets	**9.0%**	9.0%	9.0%
Actual rate of return on plan assets	**(3.2)%**	14.1%	24.1%

For the recognition of net periodic postretirement cost, the calculation of the expected return on plan assets is generally derived using a market-related value of plan assets based on average asset values at the measurement date over the last five years. The use of fair value, rather than a market-related value, of plan assets could materially affect net periodic postretirement cost.

Assumption Sensitivity

A 25 basis point increase or decrease in the expected rate of return on plan assets, discount rate, or rate of future compensation increases, would not have a material effect on 2012 postretirement expense. We estimate that every 25 basis point change in the discount rate impacts the funded status of our postretirement benefit plans by approximately $14. Similarly, every five percentage point change in the fair value of plan assets impacts the funded status by approximately $10.

Goodwill and Other Intangible Assets

We review goodwill and indefinite-lived intangible assets for impairment annually and whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable. We also review the carrying value of our finite-lived intangible assets for potential impairment when impairment indicators arise. We conduct our annual impairment test as of the first day of the fourth quarter. We perform a two-step impairment test for goodwill. In the first step, we compare the estimated fair value of each reporting unit to its carrying value. If the estimated fair value of the reporting unit exceeds the carrying value of the net assets assigned to that reporting unit, goodwill is not impaired and we are not required to perform further testing. If the carrying value of the net assets assigned to the reporting unit exceeds its fair value, then we must perform the second step of the impairment test in order to measure the impairment loss to be recorded. If the carrying value of a reporting unit's goodwill exceeds its implied fair value, then we record an impairment loss equal to the difference. In our annual impairment test for indefinite-lived intangible assets, we compare the fair value of those assets to their carrying value. We recognize an impairment loss when the estimated fair value of the indefinite-lived intangible asset is less than its carrying value. We estimate the fair value of our reporting units and intangible assets with indefinite lives using an income approach, corroborated by market multiples when appropriate. Under the income approach, we calculate fair value based on the present value of estimated future cash flows.

Determining the fair value of a reporting unit or an indefinite-lived intangible asset is judgmental in nature and involves the use of significant estimates and assumptions, particularly related to future operating results and cash flows. These estimates and assumptions include, but are not limited to, revenue growth rates and operating margins used to calculate projected future cash flows, risk-adjusted discount rates, assumed royalty rates, future economic and market conditions and identification of appropriate market comparable data. In addition, the identification of reporting units and the allocation of assets and liabilities to the reporting units when determining the carrying value of each reporting unit also requires judgment. Goodwill is tested for impairment at the reporting unit level, which, based on the applicable accounting guidance, is either the reportable segment identified in Note 22, "Segment Information," to the Consolidated Financial Statements, or one level below (e.g., the divisions of our Control Technology segment). The fair value of our reporting units and indefinite-lived intangible assets are based on estimates and assumptions that are believed to be reasonable. Significant changes to these estimates and assumptions could adversely impact our conclusions. Actual future results may differ from those estimates. Further, had different reporting units been identified or had different valuation methodologies or assumptions been utilized, the results of our impairment tests could have resulted in an impairment loss, which could have been material.

The 2011 annual goodwill impairment test indicated that the fair value of each reporting unit was significantly in excess of its respective carrying value. In connection with the Distribution of Exelis and Xylem, we conducted an interim goodwill impairment test as of October 31, 2011. The 2011 interim goodwill impairment analysis indicated the estimated fair value of our reporting units significantly exceeded their carrying value. The reporting unit with the lowest passing margin as of the 2011 interim goodwill impairment test had $56 million of goodwill and passed the test by 39%. Accordingly, no reporting unit with significant goodwill was at risk of failing step one of the goodwill impairment test at October 31, 2011. In order to evaluate the sensitivity of the fair value estimates on the goodwill impairment test, we applied a hypothetical 100 basis point increase to the discount rates utilized, a ten percent reduction in expected future cash flows, and reduced the assumed future growth rates of each reporting unit to zero. These hypothetical changes did not result in any reporting unit failing step one of the impairment test. Further, our 2011 annual indefinite-lived intangible asset impairment test did not result in an impairment charge as the estimated fair value of the assets significantly exceeded their carrying values.

Environmental Liabilities

We are subject to various federal, state, local and foreign environmental laws and regulations that require environmental assessment or remediation efforts. Accruals for environmental exposures are recorded on a site-by-site basis when it is probable that a liability has been incurred and the amount of the liability can be reasonably estimated, based on current law and existing technologies. Significant judgment is required to determine both the likelihood of a loss and the estimated amount of loss. Engineering studies, probability techniques, historical experience and other factors are used to identify and evaluate remediation alternatives and their related costs in estimating our reserve for environmental liabilities. Our environmental reserve of $102 related to environmental matters at December 31, 2011, represents management's estimate of undiscounted costs expected to be incurred related to environmental assessment or remediation efforts, as well as related legal fees, without regard to potential recoveries from insurance companies or other third parties. Our estimated liability is reduced to reflect the participation of other potentially responsible parties in those instances where it is probable that such parties are legally responsible and financially capable of paying their respective share of the relevant costs. Our environmental accruals are reviewed and adjusted for progress of investigation and remediation efforts and as additional technical or legal information become available, such as the impact of negotiations with regulators and other potentially responsible parties, settlements, rulings, advice of legal counsel, and other current information.

We closely monitor our environmental responsibilities, together with trends in the environmental laws. Environmental remediation reserves are subject to numerous inherent uncertainties that affect our ability to estimate our share of the costs. Such uncertainties involve incomplete information regarding particular sites and other potentially responsible parties, uncertainty regarding the nature and extent of contamination at each site, the extent of remediation required under existing regulations, our share of any remediation liability, if any, widely varying cost estimates associated with potential alternative remedial approaches, the length of time required to remediate a particular site, the potential effects of continuing improvements in remediation technology, and changes in environmental standards and regulatory requirements. While environmental laws and regulations are subject to change, the nature of such change is inherently unpredictable and the timing of potential changes is uncertain. The effect of legislative or regulatory changes on environmental standards could be material to the Company's financial position or results of operations. Additionally, violations by us of such laws and regulations, discovery of previously unknown or more extensive contamination, litigation involving environmental impacts, our inability to recover costs associated with any such developments, or financial insolvency of other potentially responsible parties could have a material adverse effect on our financial position, results of operations, or cash flows.

Although it is not possible to predict with certainty the ultimate costs of environmental remediation, the reasonably possible low- and high end range of our estimated environmental liability, for these environmental matters at December 31, 2011 was $81 and $175.

Recent Accounting Pronouncements

See Note 2, "Recent Accounting Pronouncements," in the Notes to the Consolidated Financial Statements for a complete discussion of recent accounting pronouncements. There were no new pronouncements which we expect to have a material impact on our financial condition and results of operations in future periods.

Forward-Looking and Cautionary Statements

Some of the information included herein includes forward-looking statements intended to qualify for the safe harbor from liability established by the Private Securities Litigation Reform Act of 1995 (the Act). These forward-looking statements include statements that describe our business strategy, outlook, objectives, plans, intentions or goals, and any discussion of future operating or financial performance. Whenever used, words such as "anticipate," "estimate," "expect," "project," "intend," "plan," "believe," "target" and other terms of similar meaning are intended to identify such forward-looking statements. Forward-looking statements are uncertain and to some extent unpredictable, and involve known and unknown risks, uncertainties and other important factors that could cause actual results to differ materially from those expressed in, or implied from, such forward-looking statements. Factors that could cause results to differ materially from those anticipated include:

- Uncertainties with respect to our estimation of asbestos liability exposures, third party recoveries and net cash flows;
- Economic, political and social conditions in the countries in which we conduct our businesses;
- Changes in U.S. or International sales and operations;
- Contingencies related to actual or alleged environmental contamination, claims and concerns;

- Decline in consumer spending;
- Revenue mix and pricing levels;
- Availability of adequate labor, commodities, supplies and raw materials;
- Foreign currency exchange rate fluctuations;
- Changes in government regulations and compliance therewith;
- Competition, industry capacity and production rates;
- Declines in orders or sales as a result of industry or geographic downturns;
- Ability of third parties, including our commercial partners, counterparties, financial institutions and insurers, to comply with their commitments to us;
- Our ability to borrow and availability of liquidity sufficient to meet our needs;
- Changes in the recoverability of goodwill or intangible assets;
- Our ability to achieve stated synergies or cost savings from acquisitions or divestitures;
- The number of personal injury claims filed against the companies or the degree of liability;
- Our ability to affect restructuring and cost reduction programs and realize savings from such actions;
- Changes in our effective tax rate as a result in changes in the geographic earnings mix, tax examinations or disputes, tax authority rulings or changes in applicable tax laws;
- Changes in technology;
- Intellectual property matters;
- Potential future postretirement benefit plan contributions and other employment and pension matters;
- Susceptibility to market fluctuations and costs as a result of becoming a smaller, more focused company after the Distribution; and
- Changes in generally accepted accounting principles.

We undertake no obligation to update any forward-looking statements, whether as a result of new information, future events or otherwise. See Item 1A. "Risk Factors," for further discussion pertaining to known and unknown risk affecting the Company.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As a result of our global operating and financing activities, we are exposed to market risks from changes in foreign currency exchange rates and commodity prices, which may adversely affect our operating results and financial position. The impact from changes in market conditions is generally minimized through our normal operating and financing activities. However, we may use derivative instruments, primarily forward contracts, to manage some of these exposures. We do not use derivative financial instruments for trading or other speculative purposes. To minimize the risk of counterparty non-performance, derivative instrument agreements are made only through major financial institutions and there is no significant concentration of exposure with any one counterparty. A summary of our accounting policies for derivative financial instruments is included in Note 1, "Significant Accounting Policies," to the Consolidated Financial Statements.

Foreign Currency Exchange Rate Exposures

Our foreign currency exchange rate risk relates to receipts from customers, payments to suppliers and intercompany transactions denominated in foreign currencies. As of December 31, 2011, we had a total of 3 forward contracts in place to mitigate exposures related to intercompany transactions with an aggregate notional amount of $64 and related net fair value less than $1. These forward contracts are all short-term in duration, generally maturing within three months from contract date. We may also use derivative financial instruments to offset risk related to receipts from customers and payments to suppliers, when it is believed that the exposure will not be limited by our normal operating and financing activities. Our principal currency exposures relate to the Euro, Czech Kurona, Chinese Renminbi, South Korean Won, Mexican Peso, British Pound, Brazilian Real, Australian Dollar and Canadian Dollar. We currently do not believe the net exposure related to receipts from customers and payments to suppliers to be significant, as such we have not entered into any derivative financial instruments to offset this potential exposure. We estimate that a hypothetical 10% adverse movement in foreign currency rates to which we are exposed would not be material to our financial position, results of operations or cash flows.

Effective January 1, 2010, Venezuela was determined to be a highly inflationary economy and we changed the functional currency of our operations in Venezuela to the U.S dollar. In addition, on January 8, 2010, Venezuela announced the devaluation of the Bolivar and provided further currency adjustments on January 1, 2011. Given our limited presence in Venezuela, the devaluation, as well as the highly inflationary accounting treatment has not resulted in, nor is it expected to have, a material impact on our results of operations, financial position or cash flows.

Interest Rate Exposures

As of December 31, 2011, we do not have a material exposure to interest rate risk as we have minimal debt. We issue commercial paper, which exposes us to changes in interest rates; however, we do not have an outstanding commercial paper balance as of December 31, 2011.

Commodity Price Exposures

Portions of our business are exposed to volatility in the prices of certain commodities, such as steel, iron, aluminum, nickel, tin, and copper, among others. Our primary exposure to commodity price volatility resides with the use of these materials in purchased component parts. We generally maintain long-term fixed price contracts on raw materials and component parts; however, we are prone to exposure as these contracts expire. We estimate that a hypothetical 10% adverse movement in prices for raw metal commodities would not be material to the financial position, results of operations or cash flows.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

See Index to Consolidated Financial Statements herein.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Attached as exhibits to the Form 10-K are certifications of the Company's Chief Executive Officer (CEO) and Chief Financial Officer (CFO), which are required in accordance with Rule 13a-14 of the Securities Exchange Act of 1934 (Act), as amended.

(a) Evaluation of Disclosure Controls and Procedures

The Company, with the participation of various levels of management, including the CEO and CFO, conducted an evaluation of effectiveness of the design and operation of our disclosure controls and procedures (as defined in the Rules 13a-15(e) and 15d-15(e) of the Act) as of December 31, 2011. Based on such evaluation, such officers have concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures are effective.

In 2002, the Company established a Disclosure Committee with responsibility for considering and evaluating the materiality of information and reviewing disclosure obligations on a timely basis. The Disclosure Committee meets regularly and assists the CEO and the CFO in designing, establishing, reviewing and evaluating the Company's disclosure controls and procedures.

(b) Management's Report on Internal Control Over Financial Reporting

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Act. The Company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

Internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, completely, accurately and fairly reflect the transactions and dispositions of the Company's assets; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America; (iii) provide reasonable assurance that Company receipts and expenditures are made only in accordance with the authorization of management and the directors of the Company, and (iv) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of assets that could have a material effect on the Consolidated Financial Statements. Internal control over financial reporting includes the controls themselves, monitoring and internal auditing practices and actions taken to correct deficiencies as identified.

Management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2011. Management based this assessment on criteria for effective internal control over financial reporting described in "Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission. Management's assessment included an evaluation of the design of the Company's internal control over financial reporting and testing of the operational effectiveness of its internal control over financial reporting. Management reviewed the results of its assessment with the Audit Committee of our Board of Directors.

Based on this assessment, management determined that, as of December 31, 2011, the Company maintained effective internal control over financial reporting.

The Company's management, including the CEO and the CFO, does not expect that our internal controls over financial reporting, because of inherent limitations, will prevent or detect all errors and all fraud. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may be inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management's assessment, included herein, should be read in conjunction with the certifications and the report issued by Deloitte & Touche LLP (Deloitte & Touche), an independent registered public accounting firm, as stated in their report, which appears subsequent to Item 9B in this Annual Report on Form 10-K.

(c) Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting during the last fiscal quarter that have materially affected or are reasonably likely to materially affect the Company's internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of
ITT Corporation
White Plains, New York

We have audited the internal control over financial reporting of ITT Corporation and subsidiaries (the "Company") as of December 31, 2011, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying *Management's Report on Internal Control Over Financial Reporting*. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on the criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended December 31, 2011 of the Company and our report dated February 29, 2012 expressed an unqualified opinion on those financial statements.

/S/ DELOITTE & TOUCHE

Stamford, Connecticut

February 29, 2012

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information called for by Item 10 with respect to directors is incorporated herein by reference to the portions of the definitive proxy statement for the Company's 2011 annual meeting of shareholders to be filed pursuant to Regulation 14A of the Exchange Act set forth under the captions "1. Election of Directors," "Information About the Board of Directors," "Section 16(a) Beneficial Ownership Reporting Compliance" and "Report of the Audit Committee."

The information called for by Item 10 with respect to executive officers is set forth above in Part I under the caption "Executive Officers of the Registrant."

ITT has adopted corporate governance principles and charters for each of its standing committees. The principles address director qualification standards, election and selection of an independent presiding director, as well as responsibilities, access to management and independent advisors, compensation, orientation and continuing education, management succession principles and board and committee self-evaluation. The corporate governance principles and charters are available on the company's website at http://www.itt.com/investors/governance/. A copy of the corporate governance principles and charters is also available to any shareholder who requests a copy from the Company's secretary.

ITT has also adopted a written code of ethics, the "Code of Conduct," which is applicable to all ITT directors, officers and employees, including the Company's Chief Executive Officer, Chief Financial Officer, and Chief Accounting Officer and other executive officers identified pursuant to this Item 10 (collectively, the Selected Officers). The 2011 Code of Conduct is available on the company's website at http://www.itt.com/news/publications/. In accordance with the SEC's rules and regulations, a copy of the code was filed as an exhibit to the 2002 Form 10-K and has been posted on our website and a copy of the code is also available to any shareholder who requests it. ITT intends to disclose any changes in or waivers from its code of ethics applicable to any Selected Officer or director on its website at www.itt.com.

Pursuant to New York Stock Exchange (NYSE) Listing Company Manual Section 303A.12(a), the Company submitted a Section 12(a) CEO Certification to the NYSE in 2011. The Company also filed with the SEC, as exhibits to the Company's current Annual Report on Form 10-K, the certifications required under Section 302 of the Sarbanes-Oxley Act for its Chief Executive Officer and Chief Financial Officer.

ITEM 11. EXECUTIVE COMPENSATION

The information called for by Item 11 is incorporated herein by reference to the portions of the definitive proxy statement referred to in Item 10 set forth under the captions "Executive Compensation" and "2011 Non-Management Director Compensation."

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information called for by Item 12 is incorporated herein by reference to the portions of the definitive proxy statement referred to in Item 10 set forth under the captions "Stock Ownership of Directors and Executive Officers," "Beneficial Ownership of ITT Corporation Common Stock" and "Equity Compensation Plan Information."

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE

The information called for by Item 13 is incorporated herein by reference portions to the definitive proxy statement referred to in Item 10.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information called for by Item 14 is incorporated herein by reference to the portions of the definitive proxy statement referred to in Item 10 set forth under the caption "2. Ratification of Appointment of the Independent Registered Accounting Firm."

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) Documents filed as a part of this report:

1. See Index to Consolidated Financial Statements appearing on page 60 for a list of the financial statements filed as a part of this report.
2. See Exhibit Index beginning on pages II-2 for a list of the exhibits filed or incorporated herein as a part of this report.

(b) Financial Statement Schedules are omitted because of the absence of the conditions under which they are required or because the required information is included in the Consolidated Financial Statements filed as part of this report.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of
ITT Corporation
White Plains, New York

We have audited the accompanying consolidated balance sheets of ITT Corporation and subsidiaries (the "Company") as of December 31, 2011 and 2010, and the related consolidated statements of income, comprehensive income, cash flows, and changes in shareholders' equity for each of the three years in the period ended December 31, 2011. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of ITT Corporation and subsidiaries as of December 31, 2011 and 2010, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2011, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2011, based on the criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 29, 2012 expressed an unqualified opinion on the Company's internal control over financial reporting.

/S/ DELOITTE & TOUCHE

Stamford, Connecticut

February 29, 2012

CONSOLIDATED INCOME STATEMENTS

(IN MILLIONS, EXCEPT PER SHARE AMOUNTS) YEARS ENDED DECEMBER 31	**2011**	2010	2009
Revenue	**$2,119**	$1,908	$1,770
Costs of revenue	**1,464**	1,301	1,207
Gross profit	**655**	607	563
Sales and marketing expenses	**167**	166	149
General and administrative expenses	**168**	176	201
Research and development expenses	**66**	61	53
Restructuring and asset impairment charges, net	**5**	3	43
Asbestos-related costs, net	**100**	385	238
Transformation costs	**396**	–	–
Operating loss	**(247)**	(184)	(121)
Interest expense	**76**	97	98
Interest income	**4**	11	17
Miscellaneous (income) expense, net	**(1)**	6	6
Loss from continuing operations before income tax expense (benefit)	**(318)**	(276)	(208)
Income tax expense (benefit)	**260**	(144)	(97)
Loss from continuing operations	**(578)**	(132)	(111)
Income from discontinued operations, including tax expense of $237, $330 and $275, respectively	**448**	807	740
Gain on sale of discontinued operation, including tax benefit of $4	**–**	129	–
Net (loss) income	**$ (130)**	$ 804	$ 629
Basic and Diluted Earnings Per Share:			
Continuing operations	**$ (6.23)**	$ (1.44)	$ (1.21)
Discontinued operations	**4.83**	10.19	8.10
Net (loss) income	**$ (1.40)**	$ 8.75	$ 6.89
Weighted average common shares – basic and diluted	**92.8**	92.0	91.3
Cash dividends declared per common share	**$1.591**	$ 2.00	$ 1.70

The accompanying Notes to Consolidated Financial Statements are an integral part of the above income statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(IN MILLIONS) YEARS ENDED DECEMBER 31	**2011**	2010	2009
Net (loss) income	**$(130)**	$804	$629
Other comprehensive (loss) income:			
Net foreign currency translation adjustment	**(40)**	(74)	126
Net change in postretirement benefit plans, net of tax (expense) benefit of $399, $(19) and $(88), respectively	**(508)**	29	141
Net change in unrealized gains on investment securities, net of tax (expense) benefit of $8, $0 and $(7), respectively	**(12)**	(1)	12
Other comprehensive (loss) income	**(560)**	(46)	279
Comprehensive (loss) income	**$(690)**	$758	$908
Disclosure of reclassification adjustments:			
Net change in postretirement benefit plans, net of tax:			
Prior service benefit (cost) from plan amendment, net of tax (expense) benefit of $(1), $1 and $(1), respectively	**$ 2**	$ (2)	$ 2
Net actuarial (loss) gain arising during the period, net of tax benefit (expense) of $443, $14 and $(61), respectively	**(580)**	(23)	95
Unrealized changes in postretirement benefit plans, net of tax	**(578)**	(25)	97
Amortization of prior service costs, net of tax benefit of $(1), $(1) and $(2), respectively	**2**	1	5
Amortization of net actuarial loss, net of tax benefit of $(42), $(33) and $(24), respectively	**68**	53	39
Total amortization from accumulated other comprehensive loss into net periodic benefit cost, net of tax	**70**	54	44
Net change in postretirement benefit plans, net of tax	**$(508)**	$ 29	$141
Net change in unrealized gains on investment securities, net of tax:			
Unrealized holding (losses) gains arising during period, net of tax benefit (expense) of $2, $(3) and $(7), respectively	**$ (2)**	$ 4	$ 12
Realized gains arising during the period, net of tax expense of $6, $3 and $0, respectively	**(10)**	(5)	–
Net change in unrealized gains on investment securities, net of tax	**$ (12)**	$ (1)	$ 12

The accompanying Notes to Consolidated Financial Statements are an integral part of the above statements of comprehensive income.

CONSOLIDATED BALANCE SHEETS

(IN MILLIONS, EXCEPT PER SHARE AMOUNTS) DECEMBER 31	**2011**	2010
Assets		
Current assets:		
Cash and cash equivalents	**$ 690**	$ 206
Receivables, net	**396**	315
Inventories, net	**254**	218
Other current assets	**422**	228
Current assets of discontinued operations	**–**	3,457
Total current assets	**1,762**	4,424
Plant, property and equipment, net	**324**	299
Deferred income taxes	**45**	320
Goodwill	**510**	504
Other intangible assets, net	**88**	92
Asbestos-related assets	**821**	930
Other non-current assets	**121**	181
Non-current assets of discontinued operations	**–**	5,865
Total non-current assets	**1,909**	8,191
Total assets	**$3,671**	$12,615
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	**$ 364**	$ 397
Accrued liabilities	**468**	442
Short-term borrowings and current maturities of long-term debt	**2**	10
Current liabilities of discontinued operations	**–**	1,892
Total current liabilities	**834**	2,741
Postretirement benefits	**315**	262
Long-term debt	**4**	1,350
Asbestos-related liabilities	**1,529**	1,559
Other non-current liabilities	**295**	325
Non-current liabilities of discontinued operations	**–**	1,917
Total non-current liabilities	**2,143**	5,413
Total liabilities	**2,977**	8,154
Shareholders' Equity:		
Common stock: Authorized – 250 shares, $1 par value per share (104.1 shares issued(a))		
Outstanding – 93.5 shares and 92.6, respectively(a)	**93**	92
Retained earnings	**852**	5,441
Accumulated other comprehensive loss:		
Postretirement benefit plans	**(153)**	(1,359)
Cumulative translation adjustments	**(97)**	276
Unrealized (loss) gain on investment securities	**(1)**	11
Total shareholders' equity	**694**	4,461
Total liabilities and shareholders' equity	**$3,671**	$12,615

(a) Shares issued and outstanding include unvested restricted common stock of 0.5 and 0.6 at December 31, 2011 and 2010, respectively.

The accompanying Notes to Consolidated Financial Statements are an integral part of the above balance sheets.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(IN MILLIONS) YEARS ENDED DECEMBER 31	**2011**	2010	2009
Operating Activities			
Net (loss) income	**(130)**	804	629
Less: Income from discontinued operations	**448**	936	740
Loss from continuing operations	**(578)**	(132)	(111)
Adjustments to loss from continuing operations			
Depreciation and amortization	**74**	66	65
Stock-based compensation	**12**	10	18
Restructuring and asset impairment charges, net	**5**	3	43
Asbestos-related costs, net	**100**	385	238
Transformation costs	**396**	–	–
Deferred income taxes	**303**	(111)	(122)
Restructuring payments	**(7)**	(27)	(30)
Asbestos-related payments	**(21)**	–	(7)
Transformation-related payments	**(355)**	–	–
Contributions to pension plans	**(30)**	(14)	(7)
Changes in assets and liabilities (net of acquisitions):			
Change in receivables	**(74)**	1	5
Change in inventories	**(38)**	(41)	(7)
Change in accounts payable	**4**	83	(18)
Change in accrued expenses	**38**	(29)	30
Change in accrued income taxes	**(99)**	(259)	95
Other, net	**(53)**	(12)	69
Net Cash – Operating activities	**(323)**	(77)	261
Investing Activities			
Capital expenditures	**(103)**	(127)	(92)
Acquisitions, net of cash acquired	**(16)**	(10)	–
Proceeds from sale of discontinued operations and other assets	**11**	1	6
Other, net	**1**	–	–
Net Cash – Investing activities	**(107)**	(136)	(86)
Financing Activities			
Short-term debt, net	**3**	(56)	(1,607)
Long-term debt repaid	**(1,319)**	(79)	(29)
Long-term debt issued	**–**	–	992
Proceeds from issuance of common stock	**53**	28	15
Tax benefit from share-based compensation	**7**	6	3
Dividends paid	**(193)**	(176)	(148)
Contributions from Exelis and Xylem, net	**1,671**	–	–
Distributions of Exelis and Xylem, net	**980**	727	277
Net Cash – Financing activities	**1,202**	450	(497)
Exchange rate effects on cash and cash equivalents	**(9)**	(22)	34
Discontinued operations:			
Operating activities	**500**	1,053	1,011
Investing activities	**(467)**	(984)	(202)
Financing activities	**(319)**	(269)	(543)
Exchange rate effects on cash and cash equivalents	**7**	4	6
Net Cash – Discontinued operations	**(279)**	(196)	272
Net change in cash and cash equivalents	**484**	19	(16)
Cash and cash equivalents – beginning of year	**206**	187	203
Cash and Cash Equivalents – End of Year	**690**	206	187
Supplemental Disclosures of Cash Flow Information			
Cash paid during the year for:			
Interest	**80**	92	90
Income taxes (net of refunds received)	**140**	343	172

The accompanying Notes to Consolidated Financial Statements are an integral part of the above statements of cash flows.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(IN MILLIONS) YEARS ENDED DECEMBER 31	SHARES 2011	SHARES 2010	SHARES 2009	DOLLARS 2011	DOLLARS 2010	DOLLARS 2009
Common Stock						
Common stock, beginning balance	**91.5**	90.8	90.3	**$ 92**	$ 91	$ 90
Activity from stock incentive plans	**1.6**	0.7	0.5	**1**	1	1
Common stock, ending balance	**93.1**	91.5	90.8	**$ 93**	$ 92	$ 91
Retained Earnings						
Retained earnings, beginning balance				**$ 5,441**	$ 4,762	$ 4,242
Net (loss) income				**(130)**	804	629
Cash dividends declared on common stock				**(147)**	(184)	(154)
Activity from stock incentive plans				**97**	59	45
Distribution of Exelis and Xylem				**(4,409)**	–	–
Retained earnings, ending balance				**$ 852**	$ 5,441	$ 4,762
Accumulated Other Comprehensive Loss						
Postretirement benefit plans, beginning balance				**$(1,359)**	$(1,388)	$(1,529)
Net change in postretirement benefit plans				**(508)**	29	141
Distribution of Exelis and Xylem				**1,714**	–	–
Postretirement benefit plans, ending balance				**$ (153)**	$(1,359)	$(1,388)
Cumulative translation adjustments, beginning balance				**$ 276**	$ 350	$ 224
Net foreign currency translation adjustment				**(40)**	(74)	126
Distribution of Exelis and Xylem				**(333)**	–	–
Cumulative translation adjustments, ending balance				**$ (97)**	$ 276	$ 350
Unrealized gain on investment securities, beginning balance				**$ 11**	$ 12	$ 1
Net change in unrealized gains on investment securities				**(12)**	(1)	11
Unrealized gain on investment securities, ending balance				**$ (1)**	$ 11	$ 12
Total accumulated other comprehensive loss				**$ (251)**	$(1,072)	$(1,026)
Total Shareholders' Equity						
Total shareholders' equity, beginning balance				**$ 4,461**	$ 3,827	$ 3,028
Net change in common stock				**1**	1	–
Net change in retained earnings				**(4,589)**	679	520
Net change in accumulated other comprehensive income				**821**	(46)	279
Total shareholders' equity, ending balance				**$ 694**	$ 4,461	$ 3,827

The accompanying Notes to Consolidated Financial Statements are an integral part of the above statements of changes in shareholders' equity.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(DOLLARS AND SHARE AMOUNTS IN MILLIONS, UNLESS OTHERWISE STATED)

NOTE 1

Description of Business, Basis of Presentation and Summary of Significant Accounting Policies

Description of Business

ITT Corporation is a global industrial company specializing in the engineering and manufacture of critical components in the aerospace, transportation, energy and industrial markets. Unless the context otherwise indicates, references herein to "ITT," "the Company," and such words as "we," "us," and "our" include ITT Corporation and its subsidiaries. ITT operates through four segments: Industrial Process consisting of industrial pumping and complementary equipment; Motion Technologies consisting of friction and shock & vibration equipment; Interconnect Solutions (ICS) consisting of electronic connectors; and Control Technologies consisting of fluid handling, motion control and vibration and shock isolation products. Financial information for our segments is presented in Note 22, "Segment Information."

Basis of Presentation

On October 31, 2011, ITT Corporation made a pro rata distribution to its shareholders consisting of all the shares of common stock of Xylem Inc. (Xylem, previously referred to as the water-related businesses), which held ITT's interests in the water businesses, and all the shares of common stock of Exelis Inc. (Exelis, previously referred to as ITT's Defense & Information Solutions segment), which held ITT's interests in the defense businesses (the Distribution). These financial statements have been reclassified to present the financial position, results of operations and cash flows of Exelis and Xylem as discontinued operations in all periods presented. For further information on the discontinued operations of Exelis and Xylem, see Note 4, "Discontinued Operations." In addition, in conjunction with the Distribution, we implemented changes to our management structure and changed our segment reporting structure.

On October 31, 2011, we completed a one-for-two reverse stock split (1:2 Reverse Stock Split) of ITT's issued and outstanding common stock, as approved by our Board of Directors. The par value of our common stock remained $1 per share following the 1:2 Reverse Stock Split. All common stock shares authorized, issued and outstanding, as well as share prices and earnings per share give effect to the 1:2 Reverse Stock Split in all periods presented.

In addition to the reclassification effects from the Distribution, certain other prior year amounts have been reclassified to conform to the current year presentation as described within these Notes to the Consolidated Financial Statements.

Significant Accounting Policies

Use of Estimates

The Consolidated Financial Statements are prepared in conformity with accounting principles generally accepted in the United States of America (GAAP). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Estimates are revised as additional information becomes available. Estimates and assumptions are used for, but not limited to, asbestos-related liabilities and recoveries from insurers and other responsible parties, revenue recognition, income tax contingency accruals and valuation allowances, postretirement obligations and assets, goodwill and other intangible asset impairment testing, environmental liabilities, allowance for doubtful accounts and inventory valuation. Actual results could differ from these estimates.

Principles of Consolidation

Our consolidated financial statements include the accounts of all majority-owned subsidiaries. ITT consolidates companies in which it has a controlling financial interest or when ITT is considered the primary beneficiary of a variable interest entity. We account for investments in companies over which we have the ability to exercise significant influence, but do not hold a controlling interest under the equity method, and we record our proportionate share of income or losses in the Consolidated Income Statements. The results of companies acquired or disposed of during the fiscal year are included in the Consolidated Financial Statements from the effective date of acquisition or up to the date of disposal or distribution. All intercompany transactions have been eliminated.

Revenue Recognition

Revenue is derived from the sale of products and services to customers. The following revenue recognition policies describe the manner in which we account for different classes of revenue transactions.

Revenue is recognized when persuasive evidence of an arrangement exists, the sales price is fixed or determinable, collectability is reasonably assured and delivery has occurred or services have been rendered. For product sales, other than long-term construction and production-type contracts (referred to as design and build arrangements), we recognize revenue at the time title and risks and rewards of ownership pass to the customer, which is generally when products are shipped, and the contractual terms have been fulfilled. Certain contracts with customers require delivery, installation, testing, certification or other acceptance provisions to be satisfied before revenue is recognized. In instances where contractual terms include a provision for customer acceptance, revenue is recognized when either (i) we have previously demonstrated that the product meets the specified criteria based on either seller or customer-specified objective criteria or (ii) on formal acceptance received from the customer where the product has not been previously demonstrated to meet customer-specified objective criteria.

We recognize revenue on product sales to channel partners, including resellers, distributors or value-added solution providers at the time of sale when the channel partners have economic substance apart from ITT and ITT has completed its obligations related to the sale. Revenue on service and repair contracts is recognized after services have been agreed to by the customer and rendered or over the service period.

Effective January 1, 2011, we adopted amended guidance on the accounting for revenue arrangements that contain multiple elements. The amended guidance was applied to new arrangements or arrangements materially modified on or after January 1, 2011 on a prospective basis.

For multiple deliverable arrangements entered into or materially modified on or after January 1, 2011, we recognize revenue based on the relative selling price if the deliverable has stand-alone value to the customer and, in arrangements that include a general right of return relative to the delivered element, performance of the undelivered element is considered probable and substantially in the Company's control. The selling price for a deliverable is based on vendor-specific objective evidence of selling price (VSOE), if available, third-party evidence of selling price (TPE), if VSOE is not available, or best estimated selling price (BESP), if neither VSOE nor TPE is available.

The deliverables in our arrangements with multiple elements include various products and may include related services, such as installation and start-up services. We allocate arrangement consideration based on the relative selling prices of the separate units of accounting determined in accordance with the hierarchy described above. For deliverables that are sold separately, we establish VSOE based on the price when the deliverable is sold separately. We establish TPE, generally for services, based on prices similarly situated customers pay for similar services from third party vendors. For those deliverables for which we are unable to establish VSOE or TPE, we estimate the selling price considering various factors including market and pricing trends, geography, product customization, and profit objectives. Revenue for multiple element arrangements is recognized when the appropriate revenue recognition criteria for the individual deliverable have been satisfied.

For arrangements entered into prior to January 1, 2011 and not subsequently materially modified, if objective and reliable evidence of fair value existed for all of the units of accounting identified, the transaction consideration was allocated based on the relative fair values of the units of accounting. Alternatively, when the evidence of fair value existed for the delivered items, but not the undelivered items, the arrangement consideration was allocated using the residual method.

We recognize revenue on certain design and build projects using the completed contract method. Amounts invoiced to customers in excess of revenue recognized are recorded as deferred revenue, until the revenue recognition criteria are satisfied, and are recorded as a component of accrued liabilities.

During the performance of design and build arrangements, estimated final contract prices and costs are reviewed quarterly. Provisions for estimated losses on uncompleted design and build arrangements are recognized in the period in which such losses are determined. Provisions for estimated losses are recorded as a component of costs of revenue.

We record a reduction in revenue at the time of sale for estimated product returns, rebates and other allowances, based on historical experience and known trends.

Revenue is reported net of any required taxes collected from customers and remitted to government authorities, with the collected taxes recorded as current liabilities until remitted to the relevant government authority.

Shipping and Handling Costs

Shipping and handling costs are recorded as a component of costs of revenue.

Product Warranties

Our standard product warranty terms generally include post-sales support and repairs or replacement of a product at no additional charge for a specified period of time. Accruals for estimated expenses related to product warranties are made at the time revenue is recognized and are recorded as a component of costs of revenue. We estimate the liability for warranty claims based on our standard warranties, the historical frequency of claims and the cost to replace or repair our products under warranty. Factors that influence our warranty liability include the number of units sold, the length of warranty term, historical and anticipated rates of warranty claims and the cost per claim.

Asbestos-Related Liabilities and Assets

ITT has been named as a defendant in numerous product liability lawsuits alleging personal injury due to asbestos exposure. We accrue the estimated value of pending claims and unasserted claims estimated to be filed over the next 10 years, including legal fees, on an undiscounted basis. Assumptions utilized in estimating the liability for both pending and unasserted claims include: disease type, average settlement costs, percentage of claims settled or dismissed, the number of claims estimated to be filed against the Company in the future and the costs to defend such claims. In light of the uncertainties and variables inherent in the long-term projection of the Company's asbestos liability, although it is probable that the Company will incur additional costs for asbestos claims filed beyond the next 10 years, we do not believe there is a reasonable basis for estimating those costs at this time.

The Company has also recorded an asbestos-related asset, comprised predominantly of insurance receivables and expected recoveries from other responsible parties. The asbestos-related asset represents our best estimate of probable recoveries from third parties for pending claims, as well as unasserted claims estimated to be filed over the next 10 years. In developing this estimate, the Company considers coverage-in-place and other settlement agreements with its insurers and other contractual agreements with responsible parties, as well as a review of expected levels of future cost recovery, the financial viability of the insurance companies or other responsible parties, the method by which losses will be allocated to the various insurance policies and the years covered by those policies, and interpretation of the various policy and contract terms and limits and their interrelationships.

As part of our ongoing review of our net asbestos exposure, each quarter we assess the most recent data available for the key inputs and assumptions, comparing the data to the expectations on which the most recent annual liability and asset estimates were based. Provided the quarterly review does not indicate a more detailed evaluation of our asbestos exposure is required, each quarter, we record a net asbestos expense to maintain a rolling 10-year time horizon. In the third quarter each year we conduct a detailed study with the assistance of outside consultants to review and update, as appropriate, the underlying assumptions used to estimate our asbestos liability and related assets, including a reassessment of the time horizon over which a reasonable estimate of unasserted claims can be projected.

Postretirement Benefit Plans

ITT sponsors pension and other employee-related defined benefit plans (collectively, postretirement benefit plans) for certain employees around the world. Postretirement benefit obligations are generally determined, where applicable, based on participant years of service, future compensation, age at retirement or termination, and medical cost trends. The determination of projected benefit obligations and the recognition of expenses related to postretirement benefit plans are dependent on various assumptions that are judgmental and developed in consultation with our actuaries and other advisors. The major assumptions involved in the measurement of our postretirement benefit plan obligations and net periodic postretirement costs primarily relate to discount rates, long-term expected rates of return on plan assets, mortality and termination rates, health care inflation trend rates and other factors. Management develops each assumption using relevant company experience in conjunction with market-related data for each individual country in which such plans exist. Actual results that differ from our assumptions are accumulated and amortized over the estimated future working life of the plan participants. For the recognition of net periodic postretirement cost, the calculation of the long-term expected return on plan assets is generally derived using a market-related value of plan assets based on yearly average asset values at the measurement date over the last five years.

The fair value of plan assets is estimated based on market prices or estimated fair value at the measurement date. See Note 17, "Postretirement Benefit Plans," for further information on the measurement of plan assets.

The funded status of each plan is recorded on our balance sheet. Actuarial gains and losses and prior service costs or credits that have not yet been recognized through net (loss) income are recorded in accumulated other comprehensive income (loss) within shareholders' equity, net of taxes, until they are amortized as a component of net periodic postretirement cost.

Stock-Based Compensation

Stock-based awards issued to employees and non-employee directors include non-qualified stock options, restricted stock awards, restricted stock units, and certain liability-based awards. Compensation costs resulting from share-based payment transactions are recognized primarily within general and administrative expenses, at fair value over the requisite service period (typically three years) on a straight-line basis. The amount of compensation recognized includes an adjustment based on an estimate of awards ultimately expected to vest. The fair value of a non-qualified stock option is determined on the date of grant using a binomial lattice pricing model incorporating multiple and variable assumptions over time, including assumptions such as employee exercise patterns, stock price volatility and changes in dividends. The fair value of restricted stock awards is determined using the closing price of the Company's common stock on date of grant. The fair value of our liability-based awards, including cash awards under our Long-Term Incentive Plan, is reassessed at the end of each reporting period.

Restructuring

We periodically initiate management approved restructuring activities to achieve cost savings through reduced operational redundancies and to strategically position ourselves in the market in response to prevailing economic conditions and associated customer demand. Costs associated with restructuring actions can include severance, infrastructure charges to vacate facilities or consolidate operations, contract termination costs and other related charges. For involuntary separation plans, a liability is recognized when it is probable and reasonably estimable. For voluntary separation plans, a liability is recognized when the employee irrevocably accepts the voluntary termination. For one-time termination benefits, such as additional severance pay or benefit payouts, and other exit costs, such as lease termination costs, the liability is measured and recognized initially at fair value in the period in which the liability is incurred, with subsequent changes to the liability recognized as adjustments in the period of change.

Income Taxes

We determine the provision for income taxes using the asset and liability approach. Under this approach, deferred income tax assets and liabilities are determined based on the estimated future tax effects of differences between the financial reporting and tax bases of assets and liabilities, applying currently enacted tax rates in effect for the year in which we expect the differences will reverse. We record a valuation allowance against our deferred tax assets when uncertainty regarding their realizability exists.

In assessing the need for a valuation allowance, we consider all available evidence, including the future reversal of existing taxable temporary differences, taxable income in carryback periods, prudent and feasible tax planning strategies, and estimated future taxable income. The valuation allowance can be affected by changes to tax regulations, interpretations and rulings, changes to enacted statutory tax rates, and changes to future taxable income estimates.

The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income (including the reversals of deferred tax liabilities) during the periods in which those deferred tax assets will become deductible. The Company's management assesses available positive and negative evidence regarding the realizability of its deferred tax assets, and records a valuation allowance when it is more likely than not that all or a portion of the deferred tax assets will not be realized. To form a conclusion, management considers positive evidence in the form of reversing temporary differences, projections of future taxable income and tax planning strategies, and negative evidence such as recent history of losses. Beginning in 2011, the Company is in a cumulative three-year loss position, which we weighted as a significant source of negative evidence indicating the need for a valuation allowance on our net deferred tax assets. Since the Company was in a three-year cumulative loss position at the end of 2011, management determined that the size and frequency of the losses from continuing operations in recent years and the uncertainty associated with projecting future taxable income supported the conclusion that a valuation allowance was required to reduce its deferred tax assets. If ITT achieves profitability in future periods, then management will evaluate whether its recent history of profitability constitutes sufficient positive evidence to support a reversal of a portion, or all, of the remaining valuation allowance.

We have not provided deferred tax liabilities for the impact of U.S income taxes on undistributed foreign earnings which we plan to reinvest indefinitely outside the United States. We have recorded deferred tax liabilities for the impact of U.S income taxes on undistributed foreign earnings which are not indefinitely reinvested outside the United States. We plan foreign earnings remittance amounts based on projected cash flow needs, as well as the working capital and long-term investment requirements of foreign subsidiaries and our domestic operations.

Furthermore, we recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position in consideration of applicable tax statutes and related interpretations and precedents and the expected outcome of the proceedings (or negotiations) with the taxing authorities. Tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than 50% likelihood of being realized on ultimate settlement.

Earnings Per Share

Basic earnings per common share considers the weighted average number of common shares outstanding, as well as outstanding unvested share-based payment awards that contain rights to nonforfeitable dividends. Diluted earnings per share considers the outstanding shares utilized in the basic earnings per share calculation as well as the dilutive effect of outstanding stock options and restricted stock that do not contain rights to nonforfeitable dividends. Diluted shares outstanding include the dilutive effect of in-the-money options, unvested restricted stock and unvested restricted stock units. The dilutive effect of such equity awards is calculated based on the average share price for each reporting period using the treasury stock method. Common stock equivalents are excluded from the computation of earnings per share if they have an anti-dilutive effect.

Cash and Cash Equivalents

ITT considers all highly liquid investments purchased with an original maturity or remaining maturity at time of purchase of three months or less to be cash equivalents.

Concentrations of Credit Risk

Financial instruments that potentially subject ITT to significant concentrations of credit risk consist principally of cash and cash equivalents and, accounts receivable from trade customers. We maintain cash and cash equivalents with various financial institutions located in different geographical regions, and our policy is designed to limit exposure with any one institution. As part of our cash and risk management processes, we perform periodic evaluations of the relative credit standing of the financial institutions. We have not sustained any material credit losses during the previous three years from instruments held at financial institutions.

Credit risk with respect to accounts receivable is generally diversified due to the large number of entities comprising ITT's customer base and their dispersion across many different industries and geographic regions. ITT performs ongoing credit evaluations of the financial condition of its third-party distributors, resellers and other customers and requires collateral, such as letters of credit and bank guarantees, in certain circumstances.

Allowance for Doubtful Accounts

We determine our allowance for doubtful accounts using a combination of factors to reduce our trade receivables balances to their estimated net realizable amount. We maintain an allowance for doubtful accounts based on a variety of factors, including the length of time receivables are past due, macroeconomic trends and conditions, significant one-time events, historical experience and the financial condition of customers. We record a specific reserve for individual accounts when we become aware of specific customer circumstances, such as in the case of bankruptcy filings or deterioration in the customer's operating results or financial position. The past due or delinquency status of a receivable is based on the contractual payment terms of the receivable. If circumstances related to the specific customer change, we adjust estimates of the recoverability of receivables as appropriate.

Inventories

Inventories, which include the costs of material, labor and overhead, are stated at the lower of cost or market, with cost generally computed on a first-in, first-out (FIFO) basis. Estimated losses from obsolete and slow-moving inventories are recorded to reduce inventory values to their estimated net realizable value. Inventory write-downs are measured as the difference between the cost of the inventory and market based assumptions about future demand and is charged to cost of sales. At the point of loss recognition, a new cost basis for that inventory is established and subsequent changes in facts and circumstances do not result in a recovery in carrying value. Inventories valued under the last-in, first-out (LIFO) method represent 17.6% and 12.8% of total 2011 and 2010 inventories, respectively. We have a LIFO reserve of $8 and $7 recorded as of December 31, 2011 and 2010, respectively.

Cost of sales is reported using standard cost techniques with full overhead absorption, which generally approximates actual cost.

Plant, Property and Equipment

Plant, property and equipment, including capitalized interest applicable to major project expenditures, are recorded at cost. Depreciation is computed on a straight-line basis over the estimated useful lives of the assets as follows: buildings and improvements – five to 40 years, machinery and equipment – two to 10 years, furniture and office equipment – three to seven years, and other – five to 40 years. Leasehold improvements are depreciated over the life of the lease or the asset, whichever is shorter. Fully depreciated assets are retained in property and accumulated depreciation accounts until disposal. Repairs and maintenance costs are expensed as incurred.

The Company enters into operating and capital leases for the use of premises and equipment. Rent expense related to operating lease agreements are recorded on a straight line basis, considering lease incentives and escalating rental payments.

Capitalized Internal Use Software

Costs incurred in the preliminary project stage of developing or acquiring internal use software are expensed as incurred. After the preliminary project stage is completed, management has approved the project and it is probable that the project will be completed and the software will be used for its intended purpose, ITT capitalizes certain internal and external costs incurred to acquire or create internal use software, principally related to software coding, designing system interfaces and installation and testing of the software. ITT amortizes capitalized internal use software costs using the straight-line method over the estimated useful life of the software, generally from three to seven years.

Investments in Corporate-Owned Life Insurance

Investments in corporate-owned life insurance (COLI) policies are recorded at their cash surrender values as of each balance sheet date. The total amounts related to the Company's investments in COLI policies are included in other non-current assets in the consolidated balance sheets and were $79 and $76 at December 31, 2011 and 2010, respectively. Changes in the cash surrender value during the period are recorded as a gain or loss within operating expenses and were not material in the years ended December 31, 2011, 2010 and 2009. These investments were made with the intention of utilizing them as a long-term funding source for deferred compensation obligations, which as of December 31, 2011 and 2010 were approximately $20 and $16, respectively, however, the COLI policies do not represent a committed funding source for these obligations and as such they are subject to claims from creditors, and we can designate them for another purpose at any time.

Long-Lived Asset Impairment
Long-lived assets, including intangible assets with finite lives and capitalized internal use software, are tested for impairment whenever events or changes in circumstances indicate their carrying value may not be recoverable. We assess the recoverability of long-lived assets based on the undiscounted future cash flow the assets are expected to generate and recognize an impairment loss when estimated undiscounted future cash flows expected to result from the use of the asset plus net proceeds expected from disposition of the asset, if any, are less than the carrying value of the asset. When an impairment is identified, we reduce the carrying amount of the asset to its estimated fair value based on a discounted cash flow approach or, when available and appropriate, to comparable market values.

Goodwill and Intangible Assets
Goodwill represents purchase consideration paid in a business combination that exceeds the values assigned to the net assets of acquired businesses. Intangible assets include customer relationships, proprietary technology, trademarks, patents and other intangible assets. Intangible assets with a finite life are generally amortized on a straight-line basis over an estimated economic useful life, which generally range from 15-20 years, and are tested for impairment if indicators of impairment are identified. Certain of our intangible assets have an indefinite life, namely certain brands and trademarks.

Goodwill and indefinite-lived intangible assets are not amortized, but rather are tested for impairment annually (or more frequently if impairment indicators arise, such as changes to the reporting unit structure, significant adverse changes in the business climate or an adverse action or assessment by a regulator). We conduct our annual impairment testing on the first day of the fourth fiscal quarter. For goodwill, the impairment test is a two-step test. In the first step, the estimated fair value of each reporting unit is compared to the carrying value of the net assets assigned to that reporting unit. If the estimated fair value of the reporting unit exceeds its carrying value, goodwill is not impaired and the second step of the impairment test is not performed. If the carrying value of the reporting unit exceeds its estimated fair value, then the second step of the impairment test is performed in order to measure the impairment loss to be recorded, if any. If the carrying value of a reporting unit's goodwill exceeds its implied fair value, then we record an impairment loss equal to the difference. We estimate the fair value of our reporting units and indefinite-lived intangible assets using an income approach. Under the income approach, we estimate fair value based on the present value of estimated future cash flows.

Business Combinations
ITT allocates the purchase price of its acquisitions to the tangible and intangible assets acquired, liabilities assumed, and non-controlling interests acquired based on their estimated fair value at the acquisition date. Changes to acquisition date fair values prior to the expiration of the measurement period, a period not to exceed 12 months from date of acquisition, are recorded as an adjustment to the associated goodwill. Changes to acquisition date fair values after expiration of the measurement period are recorded in earnings. The excess of the acquisition price over those estimated fair values is recorded as goodwill. Acquisition-related expenses and restructuring costs are recognized separately from the business combination and are expensed as incurred.

Commitments and Contingencies
We record accruals for commitments and loss contingencies for those which are both probable and the amount can be reasonably estimated. In addition, legal fees are accrued for cases where a loss is probable and the related fees can be reasonably estimated. Significant judgment is required to determine both probability and the estimated amount of loss. We review these accruals quarterly and adjust the accruals to reflect the impact of negotiations, settlements, rulings, advice of legal counsel, and other current information.

Environmental Liabilities
Accruals for environmental matters are recorded on a site-by-site basis when it is probable that a liability has been incurred and the amount of the liability can be reasonably estimated, based on current law and existing technologies. Our estimated liability is reduced to reflect the participation of other potentially responsible parties in those instances where it is probable that such parties are legally responsible and financially capable of paying their respective shares of the relevant costs. Accruals for environmental liabilities are primarily included in other non-current liabilities at undiscounted amounts and exclude claims for recoveries from insurance companies or other third parties.

Foreign Currency Translation
The national currencies of our foreign subsidiaries are generally the functional currencies. Balance sheet accounts are translated at the exchange rate in effect at the end of each period, except for equity which is translated at historical rates; income statement accounts are translated at the average rates of exchange prevailing during the period. Gains and losses resulting from foreign currency translation are reflected in the

cumulative translation adjustments component of shareholders' equity.

For foreign subsidiaries that do not use the local currency as their functional currency, foreign currency assets and liabilities are remeasured to the foreign subsidiary's functional currency using end of period exchange rates, except for nonmonetary balance sheet accounts, which are remeasured at historical exchange rates.

For transactions denominated in other than the functional currency, revenue and expenses are remeasured at average exchange rates in effect during the reporting period in which the transactions occurred, except for expenses related to nonmonetary assets and liabilities. Transaction gains or losses from foreign currency remeasurement are reported in general and administrative expenses.

Fair Value Measurements

We determine fair value as 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. We prioritize the inputs to valuation techniques used to measure fair value into three broad levels based on the observability of the input. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1), then to quoted market prices for similar assets or liabilities in active markets (Level 2) and gives the lowest priority to unobservable inputs (Level 3).

Derivative Financial Instruments

ITT uses derivative financial instruments, primarily foreign currency forward contracts, to mitigate exposure from foreign currency exchange rate fluctuations as it pertains to intercompany transactions. We do not use derivative instruments for speculative purposes. We record derivatives at their fair value as either an asset or liability. We include adjustments to reflect changes in fair values of derivatives in earnings as these contracts are not designated as hedges. The amount of gains and losses recorded related to our foreign currency exchange contracts and the net fair value of our outstanding contracts was not material as of and for the years ended December 31, 2011, 2010 and 2009. Such contracts involve the risk of non-performance by the counterparty. The fair values associated with the foreign currency contracts have been determined using the net position of the contracts and the applicable spot rates and forward rates as of the reporting date.

NOTE 2

Recent Accounting Pronouncements

Recently Adopted Accounting Pronouncements

In December 2010, the Financial Accounting Standards Board (FASB) issued additional guidance applicable to the testing of goodwill for potential impairment. Specifically, for reporting units with zero or negative carrying amounts, an entity is required to perform the second step of the goodwill impairment test (a comparison between the carrying amount of a reporting unit's goodwill to its implied fair value) if it is more likely than not that a goodwill impairment exists, considering any adverse qualitative factors. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2010. As of the date of our annual and interim goodwill impairment tests, none of our reporting units were affected by the application of this guidance as each reporting unit had a carrying amount that exceeded zero.

In April 2010, the FASB issued authoritative guidance permitting use of the milestone method of revenue recognition for research or development arrangements that contain payment provisions or consideration contingent on the achievement of specified events. On January 1, 2011, we adopted the new guidance on a prospective basis. The adoption of this guidance did not have a material impact on our financial position, results of operations or cash flows.

In October 2009, the FASB issued amended guidance on the accounting for revenue arrangements that contain multiple elements by eliminating the criteria that objective and reliable evidence of fair value for undelivered products or services needs to exist in order to be able to account separately for deliverables and eliminating the use of the residual method of allocating arrangement consideration. The amendments establish a hierarchy for determining the selling price of a deliverable and will allow for the separation of products and services in more instances than previously permitted.

We adopted the new multiple element guidance effective January 1, 2011 for new arrangements entered into or arrangements materially modified on or after that date on a prospective basis. The adoption of the new multiple element guidance did not result in a material change in either the units of accounting or the pattern or timing of revenue recognition. Additionally, the adoption of the revised multiple element arrangement guidance did not have a material impact on our financial position, results of operations or cash flows.

In October 2009, the FASB amended the accounting requirements for software revenue recognition. The objective of this update is to address the accounting for revenue arrangements that contain tangible products and software. Specifically, products that contain software that is "more than incidental" to the product as a whole will be removed from the scope of the software revenue recognition literature. The amendments align the accounting for these revenue transaction types with the amendments described for multiple element arrangements above. We adopted the provisions of this guidance for new or materially modified arrangements entered into on or after January 1, 2011 on a prospective basis. The adoption of this guidance did not have a material impact on our financial position, results of operations or cash flows.

Accounting Pronouncements Not Yet Adopted

In September 2011, the FASB provided companies with the option to make an initial qualitative evaluation, based on the entity's events and circumstances, to determine the likelihood of goodwill impairment. The result of this qualitative assessment determines whether it is necessary to perform the currently required two-step impairment test. If it is more likely than not that the fair value of a reporting unit is less than its carrying amount, a company would be required to perform the two-step impairment test. This guidance is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, with early adoption permitted. The Company could elect to apply the option in future goodwill impairment tests; however, the amendments are not expected to have a material effect on the Company's Consolidated Financial Statements.

In May 2011, the FASB issued guidance intended to achieve common fair value measurements and related disclosures between U.S. GAAP and international accounting standards. The amendments primarily clarify existing fair value guidance and are not intended to change the application of existing fair value measurement guidance. However, the amendments include certain instances where a particular principle or requirement for measuring fair value or disclosing information about fair value measurements has changed. This guidance is effective for the periods beginning after December 15, 2011 and early application is prohibited. We will adopt these amendments on January 1, 2012; however, the requirements are not expected to have a material effect on the Company's Consolidated Financial Statements.

NOTE 3

Company Transformation

As mentioned in Note 1, on October 31, 2011, the Company completed the legal and structural separation of Exelis and Xylem from the Company into two independent, publicly traded companies via a tax-free Distribution to shareholders. The Distribution was made pursuant to a Distribution Agreement, dated October 25, 2011, among ITT, Exelis and Xylem (the Distribution Agreement). With the completion of these separations, the Company disposed of its water-related businesses and Defense segment in their entirety and ceased to consolidate their financial position and results of operations in its consolidated financial statements. Accordingly, the Company has presented the financial position and results of operations of its former water-related businesses and Defense segment as discontinued operations in the consolidated financial statements for all periods presented. See Note 4, "Discontinued Operations," for additional information. The water-related businesses include the Water & Wastewater division, including its analytical instrumentation component, and the Residential & Commercial Water division previously reported within the Fluid Technology segment, as well as the Flow Control division that was previously reported within the Motion & Flow segment. The Industrial Process division, which was previously reported within the Fluid Technology segment, was not included in the Distribution and is now reported as a segment of ITT.

During 2011, we recognized pre-tax expenses of $636 in connection with activities taken to complete the Distribution and to create the revised organizational structure (referred to herein as Transformation costs). We have presented $396 of the pre-tax transformation costs within income from continuing operations and $240 within income from discontinued operations. Amounts presented within discontinued operations are costs directly related to the Distribution and provide no future benefit to the Company. The components of transformation costs incurred during 2011 are presented below.

	Continuing Operations	Discontinued Operations	Total
Loss on extinguishment of debt (see Note 16)	$ 297	$ –	$ 297
Advisory fees	–	139	139
Non-cash asset impairment[(a)]	57	8	65
IT costs	–	46	46
Employee retention and other compensation costs[(b)]	37	20	57
Lease termination and other real estate costs	4	10	14
Other costs	1	17	18
Transformation costs before income tax expense	396	240	636
Tax-related separation costs	4	7	11
Tax benefit	(143)	(74)	(217)
Total transformation costs, net of tax benefit	$ 257	$173	$ 430

(a) Includes a $55 million non-cash impairment charge related to a decision to discontinue development of an information technology consolidation initiative.

(b) Includes $17 of compensation costs recognized within continuing operations in connection with the retirement of Steven R. Loranger, our former Chairman, President and Chief Executive Officer in October 2011.

The table included below provides a rollforward of the accrual for Transformation costs for the year ended 2011.

Transformation accrual – January 1	$ 2
Charges for actions during the period:	
Continuing operations	396
Discontinued operations	240
Cash payments	(559)
Asset impairment and other non-cash charges, net	(45)
Transformation accrual – December 31	$ 34

NOTE 4

Discontinued Operations

On October 31, 2011, the Company completed the Distribution of Exelis and Xylem (see Note 1). ITT was designated as the accounting and legal spinnor with respect to the Distribution. In connection with the Distribution, ITT received a net cash transfer (the Contribution) of $683 and $988 from Exelis and Xylem, respectively. No gain or loss was recognized in connection with the Distribution. While we are a party to a Distribution Agreement and several other agreements, including a Tax Matters Agreement, Benefits and Compensation Matters Agreement and Master Transition Services Agreement, we have determined we do not have significant continuing involvement in the operations of Xylem or Exelis, nor do we expect significant continuing cash flows from Exelis or Xylem. As a result, the operating results of Exelis and Xylem through the date of the Distribution have been classified in the consolidated financial statements as discontinued operations for all periods presented.

During 2010 we sold CAS, Inc. (CAS), a component of our prior Defense & Information Solutions segment, engaging in systems engineering and technical assistance (SETA) for the U.S. Government. The sale of CAS was completed on September 8, 2010, resulting in proceeds from the sale of $237. Subsequent to this divestiture, we do not have any significant continuing involvement in the operations of CAS, nor do we expect significant continuing cash flows from CAS. Accordingly, the financial position and results of operations from CAS are reported as a discontinued operation for the 2010 and 2009 periods.

Interest expense was not allocated to the divested businesses for any of the periods presented.

Amounts presented for 2010 and 2009 have been adjusted to reflect certain immaterial corrections, primarily relating to income taxes, to the amounts previously reported in the consolidated financial statements. See Note 23, "Immaterial Corrections," for further information.

The tables below provides the operating results of discontinued operations through the date of disposal or distribution and certain Transformation costs that were incurred by ITT but qualified for classification within discontinued operations.

Year Ended 2011	Exelis	Xylem	Other(b)	Total
Revenue	$4,916	$3,107	$ –	$8,023
Transformation costs	31	75	134	240
Earnings (loss) before income taxes	473	321	(108)	686
Income tax expense (benefit)	194	70	(26)	238
Income (loss) from discontinued operations	$ 279	$ 251	$ (82)	$ 448

Year Ended 2010	Exelis(a)	Xylem	CAS	Other(b)	Total
Revenue	$5,893	$3,192	$160	$ –	$9,245
Earnings before income taxes	718	395	13	12	1,138
Gain on sale of disposal before tax	–	–	125	–	125
Income tax expense	251	51	–	25	327
Income (loss) from discontinued operations	$ 467	$ 344	$138	$(13)	$ 936

Year Ended 2009	Exelis(a)	Xylem	CAS	Other(b)	Total
Revenue	$6,059	$2,839	$231	$ –	$9,129
Earnings (loss) before income taxes	727	285	15	(12)	1,015
Income tax expense	253	14	6	2	275
Income (loss) from discontinued operations	$ 474	$ 271	$ 9	$(14)	$ 740

(a) CAS was a component of our Defense and Information Solutions business, which was distributed as Exelis. The table above presents Exelis without CAS, which was disposed during 2010.

(b) Amounts presented in the "Other" column within the tables above relate to various divested ITT businesses accounted for as discontinued operations in the year of divestiture for which legacy liabilities remain, as well as certain Transformation costs which were directly related to the Distribution and provide no future benefit to the Company. See Note 3, "Company Transformation" for further information.

The table below provides the major components of assets and liabilities at December 31, 2010 that were included in the Distribution and includes those assets and liabilities that were distributed to Exelis and Xylem which were not part of their historical operations.

	Exelis	Xylem	Total
Cash and cash equivalents	$ 18	$ 808	$ 826
Receivables, net	958	690	1,648
Inventories, net	239	389	628
Other current assets	188	167	355
Total current assets	1,403	2,054	3,457
Plant, Property and Equipment, net	462	465	927
Goodwill	2,156	1,617	3,773
Other intangible assets	258	416	674
Other non-current assets	243	248	491
Total assets	4,522	4,800	9,322
Accounts payable	326	321	647
Accrued liabilities and other current liabilities	884	361	1,245
Total current liabilities	1,210	682	1,892
Postretirement benefits	1,223	257	1,480
Other non-current liabilities	113	324	437
Total liabilities	$2,546	$1,263	$3,809

In order to effect the Distribution and govern ITT's relationship with Exelis and Xylem after the Distribution, ITT entered into a distribution agreement and several other agreements, including a tax matters agreement, employee benefits and compensation agreement and master transition services agreement. Information on the agreements utilized to effectuate the Distribution are provided below.

Distribution Agreement

The Distribution Agreement between ITT and Exelis and Xylem contains the key provisions relating to the separation of the businesses of Exelis and Xylem from ITT and the distribution of the shares of Exelis and Xylem common stock to our shareholders. The Distribution Agreement provides the framework for the allocation, transfer and assumption of assets and liabilities among ITT, Exelis and Xylem as well as the settlement or extinguishment of certain liabilities and other obligations between and among ITT, Exelis and Xylem. Under the Distribution Agreement, we agreed to indemnify Exelis and Xylem and their respective subsidiaries and affiliates, subject to limited exceptions with respect to certain employee claims, against claims and liabilities related to the past operation of ITT's business (other than the liabilities of the divested businesses) and Exelis and Xylem agreed to indemnify us against claims and liabilities related to their respective businesses. The Distribution Agreement establishes that certain liabilities, e.g., the bond litigation, referenced in Note 20, "Commitments and Contingencies," will be shared 21% to ITT, 40% to Exelis, and 39% to Xylem.

In connection with the Distribution, ITT retained certain material contingent legacy liabilities involving asbestos and environmental matters. See Note 20, "Commitments and Contingencies," for information regarding asbestos and environmental related contingencies.

Tax Matters Agreement

On October 25, 2011, we entered into a Tax Matters Agreement with Exelis and Xylem that governs the respective rights, responsibilities and obligations of the companies after the Distribution with respect to tax liabilities and benefits, tax attributes, tax contests and other tax sharing regarding U.S. Federal, state, local and foreign income taxes, other tax matters and related tax returns. Exelis and Xylem have liability with ITT to the U.S. Internal Revenue Service (IRS) for the consolidated U.S. Federal income taxes of the ITT consolidated group relating to the taxable periods in which Exelis and Xylem were part of that group. However, the Tax Matters Agreement specifies the portion, if any, of this tax liability for which ITT, Exelis and Xylem will bear responsibility, and ITT, Exelis and Xylem agreed to indemnify each other against any amounts for which they are not responsible. The Tax Matters Agreement also provides special rules for allocating tax liabilities in the event that the Distribution is determined to not be tax-free. The Tax Matters Agreement provides for certain covenants that may restrict our ability to pursue strategic or other transactions that otherwise could maximize the value of our business and may discourage or delay a change of control that may be considered favorable. Though valid as between the parties, the Tax Matters Agreement will not be binding on the IRS.

Pursuant to the Tax Matters Agreement, as the shared income tax liabilities are settled, ITT will make payments up to certain specified thresholds, with payments in excess of those specified thresholds shared among ITT, Exelis, and Xylem. If payments to the taxing authorities are less than certain specified thresholds, ITT will make payments up to the remaining specified thresholds to Exelis and Xylem. Settlement is expected to occur as the audit process by applicable taxing authorities is completed for the impacted years and cash payments are made. Given the nature of the shared tax liabilities, the maximum amount of potential future payments is not determinable. Any such cash payments, when they occur, will reduce the liability for uncertain tax positions as such payments represent an equivalent reduction of risk. At December 31, 2011, ITT's accrual for uncertain tax positions includes amounts related to certain shared tax liabilities; however, no receivables from Exelis or Xylem have been recorded as our estimate of their portion of the shared tax liabilities is not more than the amounts currently accrued for the uncertain tax position. If our estimate of exposures to the shared tax liabilities increases above the specified threshold, a receivable would be recorded. At December 31, 2011, there is a tax indemnification liability recorded of $4 due to Xylem.

Adjustments in the future for the impact of filing final income tax returns in certain jurisdictions where those returns include a combination of ITT, Exelis and Xylem legal entities and for certain amended income tax returns for the periods prior to the Distribution may be recorded to either shareholders' equity or the statement of income depending on the specific item giving rise to the adjustment.

Benefits and Compensation Matters Agreement

On October 25, 2011, we entered into a Benefits and Compensation Matters Agreement with Exelis and Xylem that governs the respective rights, responsibilities and obligations of Exelis, Xylem and ITT after the Distribution with respect to transferred employees, defined benefit pension plans, defined contribution pension plans, nonqualified pension plans, employee health and welfare benefit plans, incentive plans, corporate-owned life insurance, stock equity awards, foreign benefit plans, director plans and collective bargaining agreements. The Benefits and Compensation Matters Agreement provides for the allocation and treatment of assets and liabilities arising out of incentive plans, pension plans and employee welfare benefit programs in which Exelis and Xylem employees participated prior to the Distribution. Generally, Exelis and Xylem assumed or retained sponsorship of, and liabilities relating to, employee compensation and benefit programs relating to Exelis and Xylem current employees.

The Benefits and Compensation Matters Agreement also provided that outstanding ITT equity awards would be equitably adjusted in connection with the Distribution. All outstanding ITT equity awards held by employees of Exelis as of the Distribution Date were substituted for Exelis equity awards and all outstanding ITT equity awards held by employees of Xylem as of the Distribution Date were substituted for Xylem equity awards. As described in Note 18, "Long-Term Incentive Employee Compensation," the substitution preserved the economic value of the cancelled ITT equity awards for employees of Exelis and Xylem as of the Distribution Date. Subject to the applicable transition period with respect to certain benefit plans or programs, after the Distribution, employees of Exelis and Xylem no longer participate in ITT's plans or programs, and Exelis and Xylem have established or maintained plans or programs for their employees.

Master Transition Services Agreement

On October 25, 2011, we entered into a Master Transition Services Agreement with Exelis and Xylem, under which each of Exelis and Xylem or their respective affiliates provide us with certain services (including information technology, financial, procurement and human resource services, benefits support services and other specified services), and we or certain of our affiliates provide each of Exelis and Xylem certain services (including information technology, human resources services and other specified services). These services will initially be provided at cost with scheduled, escalating increases to up to cost plus 10% and generally extend for a period of 3 to 24 months and are intended to help ensure an orderly transition for each of Exelis, Xylem and ITT following the Distribution.

During November and December of 2011, we billed Exelis and Xylem approximately $22, primarily relating to active employee health benefits which continued to be administered by ITT. On January 1, 2012, the administration of the employee health benefit plans was transferred to Exelis and Xylem. Total billings by Exelis and Xylem to ITT, following the Distribution, amount to less than $1. As of December 31, 2011, we have an aggregate receivable and payable, associated with transactions related to the Master Transition Services Agreement, of less than $1 each.

Subcontract Pending Novation

On October 31, 2011, we entered into a Subcontract Agreement Pending Novation with Exelis through which ITT engaged Exelis as a subcontractor for approximately 425 U.S. government contracts. Exelis will be obligated to directly perform to the contract specifications to the satisfaction of the U.S. Government as if the contracts had been novated. The

Subcontract Agreement Pending Novation will remain in effect until the earlier of the U.S. Government's agreement to novate is completed or performance under the contract is completed. ITT and Exelis are working with the U.S. Government to finalize the novation of the underlying contracts and do not expect any disruptions as a result of this process.

All rights and benefits conferred or accruing under the contracts pending novation inure to Exelis. Pursuant to the terms of the Subcontract Agreement Pending Novation, ITT is obligated to immediately deposit all proceeds it receives under such government contracts into a bank account controlled by Exelis. Exelis has indemnified ITT against claims and liabilities related to the U.S. Government contracts pending novation arising in connection with performance under the contracts.

While the novation is pending, ITT does not have the ability to significantly influence Exelis' performance under the contracts as Exelis acts as the contracted party and has assumed control of all legal matters, including with respect to audits performed by the U.S. Government. Further, ITT has granted Exelis the right to, among other things, (i) prepare, execute and submit invoices in the name of ITT, (ii) send correspondence relating to matters under such contract in the name of ITT and (iii) otherwise exercise all rights in respect of such contract in the name of ITT. The U.S. government was billed approximately $250 from the Distribution Date through December 31, 2011 for contracts awaiting novation. Revenues and costs resulting from activities performed by Exelis on these contracts after the Distribution Date have been recorded on a net basis in ITT's financial statements, resulting in no effect on any amounts reported in ITT's financial statements.

NOTE 5

Acquisitions

During 2011, we spent $16, net of cash acquired, on acquisitions that were not material individually or in the aggregate to our results of operations or financial position. The most significant of these acquisitions was Blakers Pump Engineers Unit Trust (Blakers) on October 27, 2011 for $15, net of cash acquired. Blakers, reported within the Industrial Process segment, is a supplier of process and industrial pumping equipment serving customers in the oil & gas, mining, power, and general markets.

During 2010, we spent $10, net of cash acquired, on the acquisition of Canberra Pumps do Brasil (Canberra). Canberra, a manufacturer of pump equipment serving customers in the chemical, pulp and paper, and general industry pump markets. Canberra is reported within the Industrial Process segment.

Our financial statements include the results of operations and cash flows from each of our acquisitions prospectively from their respective acquisition date; however, these results were not material during the years ended December 31, 2011, 2010 or 2009 and accordingly, pro forma results of operations have not been presented.

NOTE 6

Restructuring and Asset Impairment Charges, net

The components of restructuring and asset impairment charges incurred during each of the previous three years ended December 31, 2011, excluding impairment charges of $55 incurred during 2011 in connection with the Distribution, are presented below.

	2011	2010	2009
By component:			
Severance charges	**$4**	$ 2	$40
Other restructuring charges	**1**	2	5
Reversal of restructuring accruals	**–**	(1)	(2)
Restructuring and asset impairment charge, net	**$5**	$ 3	$43
By segment:			
Industrial Process	**$–**	$ 1	$11
Motion Technologies	**–**	–	21
Interconnect Solutions	**3**	–	7
Control Technologies	**2**	2	3
Corporate and Other	**–**	–	1

The following table displays a rollforward of the restructuring accruals, presented on our Consolidated Balance Sheet within accrued liabilities, for the years ended December 31, 2011 and 2010.

	2011	2010
Restructuring accruals – January 1	**$ 6**	$ 33
Charges for plans initiated during the year	**3**	2
Charges for plans initiated in prior years	**2**	2
Cash payments	**(7)**	(27)
Asset write-offs	**–**	(1)
Reversal of accruals	**–**	(1)
Foreign exchange translation and other	**–**	(2)
Restructuring accruals – December 31	**$ 4**	$ 6
By accrual type:		
Severance accrual	**$ 4**	$ 5
Facility carrying and other costs accrual	**–**	1
By segment:		
Industrial Process	**$ –**	$ –
Motion Technologies	**1**	4
Interconnect Solutions	**3**	–
Control Technologies	**–**	1
Corporate and Other	**–**	1

The following is a rollforward of employee position eliminations associated with restructuring activities for the years ended December 31, 2011 and 2010:

	2011	2010
Planned reductions – January 1	**113**	257
Additional planned reductions	**52**	75
Actual reductions	**(136)**	(219)
Planned reductions – December 31	**29**	113

Strategic Relocation of Manufacturing Operations

During the fourth quarter of 2009, we initiated an action within Motion Technologies to relocate certain of our production operations to lower cost regions. This action resulted in $21 of total restructuring charges, primarily related to employee severance costs associated with the total headcount reduction of 175, including 153 factory workers, 18 office workers and 4 management employees. This action was completed during 2010.

NOTE 7

Income Taxes

For each of the three years ended December 31, 2011, the tax data related to the loss from continuing operations is as follows:

	2011	2010	2009
Income components:			
United States	**$ (466)**	$(395)	$(306)
International	**148**	119	98
Total pre-tax loss from continuing operations	**$ (318)**	$(276)	$(208)
Income tax expense (benefit) components:			
Current income tax expense (benefit):			
United States – federal	**$ (80)**	$ (61)	$ 9
United States – state and local	**(12)**	–	(2)
International	**49**	28	18
Total current income tax (benefit) expense	**(43)**	(33)	25
Deferred income tax expense (benefit):			
United States – federal	**319**	(100)	(115)
United States – state and local	**(15)**	(15)	(9)
International	**(1)**	4	2
Total deferred income tax expense (benefit)	**303**	(111)	(122)
Total income tax expense (benefit)	**$ 260**	$(144)	$ (97)
Effective income tax rate	**(81.8)%**	52.2%	46.6%

A reconciliation of the tax expense (benefit) for continuing operations from the U.S. statutory income tax rate to the effective income tax rate as reported is as follows for each of the three years ended December 31, 2011:

	2011	2010	2009
Tax provision at U.S. statutory rate	**35.0%**	35.0%	35.0%
Foreign tax rate differential	**4.2**	2.2	1.9
State and local income tax	**0.5**	5.6	5.8
Tax on undistributed foreign earnings	**(21.8)**	–	–
Change in state tax rate	**9.7**	–	–
Valuation allowance on realizability of deferred tax assets	**(106.7)**	14.6	6.6
U.S. permanent items	**–**	–	(6.5)
Audit settlements	**–**	–	(1.0)
Medicare	**0.4**	(4.2)	–
U.S. tax on foreign earnings	**(6.8)**	(16.0)	–
Tax credits	**7.2**	12.6	5.3
Other adjustments	**(3.5)**	2.4	(0.5)
Effective income tax rate	**(81.8)%**	52.2%	46.6%

We recorded the valuation allowance in 2011 primarily because 2011 operating results produced a cumulative three-year loss, which is considered a significant factor that is difficult to overcome when determining whether a valuation allowance is required. Since the Company was in a three-year cumulative loss position at the end of 2011, management determined that the size and frequency of the losses from continuing operations in recent years and the uncertainty associated with projecting future taxable income supported the conclusion that a valuation allowance was required to reduce its deferred tax assets.

As a result of the Distribution and its impacts on the Company's expected liquidity, investment opportunities and other factors, the Company determined that certain earnings generated in Luxemburg, Japan, and South Korea were no longer considered to be indefinitely reinvested. As a result of the change in intent, the Company recorded $69 of income tax expense on these undistributed foreign earnings. However, as of December 31, 2011, we have not provided for deferred taxes on the remaining excess of financial reporting over tax basis of investments in foreign subsidiaries in the amount of $370 because we plan to reinvest such earnings indefinitely outside the United States. While the amount of federal income taxes, if such earnings are distributed in the future, cannot be determined, such taxes may be reduced by tax credits and other deductions.

As a consequence of the Distribution, certain state deferred tax assets were revalued based on enacted tax rates using different state apportionment factors, effectively increasing the future state tax rates at which these deferred tax assets will be benefitted resulting in a $31 income tax benefit.

Deferred tax assets and liabilities are determined based on temporary differences between the financial reporting and tax bases of assets and liabilities, applying enacted tax rates in effect for the year in which we expect the differences will reverse.

Deferred tax assets and liabilities include the following:

	2011	2010
Deferred Tax Assets:		
Accruals	**$ 355**	$303
Employee benefits	**135**	69
Credit carryforwards	**35**	7
Loss carryforwards	**65**	57
Other	**40**	60
Subtotal	**630**	496
Valuation allowance	**(438)**	(28)
Net deferred tax assets	**$ 192**	$468
Deferred Tax Liabilities:		
Undistributed earnings	**$ (69)**	$ –
Intangibles	**(51)**	(50)
Accelerated depreciation	**(21)**	(23)
Investment	**(1)**	(1)
Total deferred tax liabilities	**$(142)**	$ (74)

Deferred taxes in the Consolidated Balance Sheets consist of the following:

	2011	2010
Current assets	**$ 25**	$ 85
Non-current assets	**45**	320
Current liabilities	**(2)**	–
Other non-current liabilities	**(18)**	(11)
Net deferred taxes	**$ 50**	$394

We have the following attributes available for utilization:

ATTRIBUTE	AMOUNT	FIRST YEAR OF EXPIRATION
U.S. federal net operating losses	$ 85	2031
U.S. state net operating losses	2,519	2012
Federal and state capital losses	13	2013
U.S. federal tax credits	33	2012
U.S. state tax credits	12	2012
Foreign net operating losses	87	2012

As of December 31, 2011, a valuation allowance of $438 had been established to reduce the deferred income tax asset related to certain U.S. state and foreign net operating losses and U.S. capital loss carryforwards. During 2011, the valuation allowance increased by $410 resulting from the following: an increase of $340 attributable to U.S. federal and state net noncurrent temporary differences, an increase of $57 attributable to U.S. state net operating loss and credit carryforwards, an increase of $12 attributable to foreign net operating loss carryforwards and foreign investments, and an increase of $1 attributable to U.S. federal capital loss carryforwards.

Shareholders' equity at December 31, 2011 and 2010 reflects excess income tax benefits related to stock-based compensation in 2011 and 2010 of approximately $7 and $6, respectively.

Uncertain Tax Positions

We recognize income tax benefits from uncertain tax positions only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the Consolidated Financial Statements from such positions are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement.

A reconciliation of the beginning and ending amount of unrecognized tax benefits for each of the three years ended December 31, 2011 is as follows:

	2011	2010	2009
Unrecognized tax benefits – January 1	**$169**	$149	$126
Additions for:			
Prior year tax positions	**1**	17	28
Current year tax positions	**15**	48	2
Purchase accounting	**–**	5	–
Reductions for:			
Prior year tax positions	**(21)**	(38)	(6)
Settlements	**–**	(12)	(1)
Unrecognized tax benefits – December 31	**$164**	$169	$149

As of December 31, 2011, $92 of the unrecognized tax benefits would affect the effective tax rate if realized. Included in the balance at December 31, 2011 are tax positions of $72, which, because of deferred tax accounting would not impact the annual effective rate, but could accelerate the payment of cash to the taxing authority. See Note 4, "Discontinued Operations" for discussion of the Tax Matters Agreement.

We do not believe that the uncertain tax positions will significantly change within twelve months of the reporting date.

In many cases, uncertain tax positions are related to tax years that remain subject to examination by the relevant taxing authorities. The following table summarizes the earliest open tax years by major jurisdiction:

JURISDICTION	EARLIEST OPEN YEAR
Germany	2006
Italy	2005
Netherlands	2008
United Kingdom	2008
United States	2007

We classify interest relating to tax matters as a component of interest expense and tax penalties as a component of income tax expense in our Consolidated Income Statement. During 2011 and 2010, we recognized less than $1 in net interest expense related to tax matters. We had $18 and $14 of interest accrued as of December 31, 2011 and 2010, respectively.

NOTE 8

Earnings Per Share

The following table provides a reconciliation of the data used in the calculation of basic and diluted loss per share computations for loss from continuing operations for the years ended December 31, 2011, 2010 and 2009. The presentation gives effect to the 1:2 Reverse Stock Split, which occurred after market close on October 31, 2011.

	2011	2010	2009
Loss from continuing operations	**$ (578)**	$ (132)	$ (111)
Weighted average common shares outstanding	**92.2**	91.2	90.5
Add: Weighted average restricted stock awards outstanding[(a)]	**0.6**	0.8	0.8
Basic weighted average common shares outstanding	**92.8**	92.0	91.3
Add: Dilutive impact of stock options	**N/A**	N/A	N/A
Diluted weighted average common shares outstanding	**92.8**	92.0	91.3
Basic and diluted loss per share	**$(6.23)**	$(1.44)	$(1.21)

(a) Restricted stock awards containing rights to non-forfeitable dividends which participate in undistributed earnings with common shareholders are considered participating securities for purposes of computing earnings per share.

Shares underlying stock options excluded from the computation of diluted loss per share because they were anti-dilutive were as follows:

	2011	2010	2009
Anti-dilutive stock options	**2.1**	1.7	1.5
Average exercise price[(b)]	**$16.70**	$85.08	$80.58
Years of expiration	**2012-2021**	2012-2020	2012-2016

(b) The decrease in average exercise price of anti-dilutive stock options from 2010 to 2011 resulted from the change in stock price of ITT common stock following the Distribution.

NOTE 9

Receivables, Net

	2011	2010
Trade accounts receivable	**$361**	$305
Notes receivable	**7**	5
Other receivables	**41**	18
Receivables, gross	**409**	328
Allowance for doubtful accounts	**(13)**	(13)
Receivables, net	**$396**	$315

The following table displays an aggregate rollforward of the allowance for doubtful accounts, for the years ended December 31, 2011 and 2010.

	2011	2010	2009
Allowance for doubtful accounts – January 1	**$13**	$21	$12
Charges (benefits) to income	**2**	(3)	13
Write-offs	**(1)**	(3)	(3)
Foreign currency and other	**(1)**	(2)	(1)
Allowance for doubtful accounts – December 31	**$13**	$13	$21

NOTE 10

Inventories, Net

	2011	2010
Finished goods	**$ 62**	$ 62
Work in process	**49**	38
Raw materials	**125**	107
Total product inventory	**236**	207
Inventoried costs related to long-term contracts	**65**	44
Less – progress payments	**(47)**	(33)
Inventoried costs related to long-term contracts, net	**18**	11
Inventories, net	**$254**	$218

NOTE 11

Other Current and Non-Current Assets

	2011	2010
Current deferred income taxes	**$ 25**	$ 85
Asbestos-related current assets	**133**	105
Income tax receivable	**164**	–
Other	**100**	38
Other current assets	**$422**	$228
Other employee benefit-related assets	**$ 79**	$ 76
Capitalized software costs	**13**	67
Other	**29**	38
Other non-current assets	**$121**	$181

As described in Note 3, "Company Transformation," during the first quarter of 2011 we discontinued the development of an information technology consolidation initiative and recorded a capitalized software impairment charge of $55.

NOTE 12

Plant, Property and Equipment, Net

	2011	2010
Land and improvements	**$ 17**	$ 17
Buildings and improvements	**163**	164
Machinery and equipment	**738**	710
Furniture, fixtures and office equipment	**62**	59
Construction work in progress	**46**	38
Other	**8**	11
Plant, property and equipment, gross	**1,034**	999
Less – accumulated depreciation	**(710)**	(700)
Plant, property and equipment, net	**$ 324**	$ 299

Depreciation expense of $57, $52 and $54 was recognized in 2011, 2010 and 2009, respectively.

NOTE 13

Goodwill and Other Intangible Assets, Net

Goodwill

Changes in the carrying amount of goodwill for the years ended December 31, 2011 and 2010 by segment are as follows:

	Industrial Process	Motion Technologies	Interconnect Solutions	Control Technologies	Total
Goodwill – January 1, 2010	$184	$52	$72	$198	$506
Goodwill acquired	3	–	–	–	3
Foreign currency	1	(4)	(2)	–	(5)
Goodwill – December 31, 2010	188	48	70	198	504
Goodwill acquired	**8**	**–**	**3**	**–**	**11**
Adjustments to purchase price allocations	**(3)**	**–**	**–**	**–**	**(3)**
Foreign currency	**–**	**(1)**	**(1)**	**–**	**(2)**
Goodwill – December 31, 2011	**$193**	**$47**	**$72**	**$198**	**$510**

Goodwill of $2,156 and $1,617 was disposed of during 2011 related to the Distribution of Exelis and Xylem, respectively. Goodwill of $76 was disposed of during 2010 related to the sale of CAS. See Note 4, "Discontinued Operations" for further information.

Based on the results of our annual impairment tests, performed as of October 1, 2011, and subsequent tests performed as of the Distribution Date for Exelis and Xylem, we determined that no impairment of goodwill existed as of either measurement date in 2011. However, future goodwill impairment tests could result in a charge to earnings. We will continue to evaluate goodwill on an annual basis as of the beginning of our fourth fiscal quarter and whenever events and changes in circumstances indicate there may be a potential impairment.

Other Intangible Assets

Information regarding our other intangible assets is as follows:

	GROSS CARRYING AMOUNT	ACCUMULATED AMORTIZATION	NET INTANGIBLES
Customer relationships	**$ 77**	**$(24)**	**$53**
Proprietary technology	**20**	**(7)**	**13**
Trademarks	**3**	**(1)**	**2**
Patents and other	**5**	**(2)**	**3**
Indefinite-lived intangibles	**17**	**–**	**17**
Intangibles – December 31, 2011	**$122**	**$(34)**	**$88**
Customer and distributor relationships	$ 74	$(18)	$56
Proprietary technology	20	(5)	15
Trademarks	3	(1)	2
Patents and other	4	(2)	2
Indefinite-lived intangibles	17	–	17
Intangibles – December 31, 2010	$118	$(26)	$92

Indefinite-lived intangibles consist of brands and trademarks. Based on the results of its annual impairment tests, we determined that no impairment of the indefinite-lived intangibles existed as of the measurement date in 2011 or 2010. However, future impairment tests could result in a charge to earnings. We will continue to evaluate the indefinite-lived intangible assets on an annual basis as of the beginning of our fourth fiscal quarter and whenever events and changes in circumstances indicate there may be an indicator of potential impairment.

Customer relationships, proprietary technology, trademarks, and patents and other are amortized over weighted average lives of approximately 14.3 years, 14.1 years, 7.4 years and 11.7 years, respectively.

Amortization expense related to intangible assets for 2011, 2010 and 2009 was $10, $8 and $8, respectively. Estimated amortization expense for each of the five succeeding years is as follows:

Year	Estimated Amortization Expense
2012	$10
2013	9
2014	8
2015	7
2016	7

NOTE 14
Accrued Liabilities and Other Non-Current Liabilities

	2011	2010
Compensation and other employee-benefits	**$172**	$167
Asbestos-related liability	**139**	117
Customer-related liabilities	**32**	21
Accrued warranty costs	**26**	27
Accrued income taxes	**23**	24
Environmental and other legal matters	**19**	21
Other accrued liabilities	**57**	65
Accrued liabilities	**$468**	$442
Deferred income taxes and other tax-related accruals	**$136**	$129
Environmental	**91**	93
Compensation and other employee-related benefits	**46**	44
Product liability, guarantees and other legal matters	**2**	39
Other	**20**	20
Other non-current liabilities	**$295**	$325

NOTE 15
Leases and Rentals

ITT leases certain offices, manufacturing buildings, land, machinery, automobiles, computers and other equipment. The majority of leases expire at various dates through 2027 and may include renewal and payment escalation clauses. ITT often pays maintenance, insurance and tax expense related to leased assets. Rental expenses under operating leases were $16, $19 and $25 for 2011, 2010 and 2009, respectively. Future minimum operating lease payments under non-cancellable operating leases with an initial term in excess of one year as of December 31, 2011 are shown below.

2012	$ 17
2013	12
2014	10
2015	9
2016	8
2017 and thereafter	78
Total minimum lease payments	$134

NOTE 16
Debt

	2011	2010
Short-term loans	**$2**	$ –
Current maturities of long-term debt and other	**–**	10
Short-term debt and current maturities of long-term debt	**2**	10
Non-current maturities of long-term debt	**4**	1,256
Non-current capital leases	**–**	57
Deferred gain on interest rate swaps	**–**	45
Unamortized discounts and debt issuance costs	**–**	(8)
Long-term debt	**4**	1,350
Total debt	**$6**	$1,360

During 2011, we reclassified the presentation of amounts reported within the long-term debt balance sheet account as of December 31, 2010, related to non-current capital leases by reclassifying $57 from non-current maturities of long-term debt to non-current capital leases. This reclassification had no impact on amounts reported within the 2010 Consolidated Income Statements or net cash from financing activities within the Consolidated Statements of Cash Flows.

Revolving Credit Facility

On October 25, 2011, we entered into a competitive advance and revolving credit facility agreement (2011 Revolving Credit Agreement) with a consortium of third party lenders including JP Morgan Chase Bank, N.A., as administrative agent, and Citibank, N.A. as syndication agent. Upon its effectiveness at the Distribution, this agreement replaced our existing $1,500 three-year revolving credit facility due August 2013. The 2011 Revolving Credit Agreement provides for a four-year maturity with a one-year extension option upon satisfaction of certain conditions, and comprises an aggregate principal amount of up to $500 of (i) revolving extensions of credit (the revolving loans) outstanding at any time, (ii) competitive advance borrowing option which will be provided on an uncommitted competitive advance basis through an auction mechanism (the competitive advances), and (iii) letters of credit in a face amount up to $100 at any time outstanding. Subject to certain conditions, we are permitted to terminate permanently the total commitments and reduce commitments in minimum amounts of $10. We are also permitted, subject to certain conditions, to request that lenders increase the commitments under the facility by up to $200 for a maximum aggregate principal amount of $700. Voluntary prepayments are permitted in minimum amounts of $50.

At our election, the interest rate per annum applicable to the competitive advances will be based on either (i) a Eurodollar rate determined by reference to LIBOR, plus an applicable margin offered by the lender making such loans and accepted by us or (ii) a fixed percentage rate per annum specified by the lender making such loans. At our election, interest rate per annum applicable to the revolving loans will be based on either (i) a Eurodollar rate determined by reference to LIBOR, adjusted for statutory reserve requirements, plus an applicable margin or (ii) a fluctuating rate of interest determined by reference to the greatest of (a) the prime rate of JPMorgan Chase Bank, N.A., (b) the federal funds effective rate plus one-half of 1% or (c) the 1-month LIBO rate, adjusted for statutory reserve requirements, plus 1%, in each case, plus an applicable margin.

Our obligations under the credit facility are unconditionally guaranteed by each of our direct or indirect domestic subsidiaries.

The credit facility contains customary affirmative and negative covenants that, among other things, will limit or restrict our ability to: incur additional debt or issue guarantees; create liens; enter into certain sale and lease-back transactions; merge or consolidate with another person; sell, transfer, lease or otherwise dispose of assets; liquidate or dissolve; and enter into restrictive covenants. Additionally, the 2011 Revolving Credit Agreement requires us not to permit the ratio of consolidated total indebtedness to consolidated earnings before interest, taxes, depreciation and amortization (EBITDA) (leverage ratio) to exceed 3.00 to 1.00 at any time, or the ratio of consolidated EBITDA to consolidated interest expense (interest coverage ratio) to be less than 3.00 to 1.00. At December 31, 2011, our interest coverage ratio and leverage ratio were well in excess of the minimum requirements.

Long-Term Debt

The following table summarizes the carrying and fair value of our long-term outstanding notes and debentures by maturity date at December 31, 2010. The fair value of our outstanding commercial paper and short-term loans approximates carrying value.

		2010	
	Interest Rate	Carrying Value	Fair Value
MATURITY DATE:			
May 2014	4.90%	$ 500	$ 538
May 2019	6.125%	500	553
November 2025	7.40%	250	311
August 2048	(a)	1	1
December 2011 – 2014	4.70%	66	69
Various 2011 – 2022	(b)	6	6
		$1,323	$1,478

(a) Variable rate debt with an interest rate of 0.19% as of December 31, 2010.

(b) Includes individually immaterial notes, bonds and capital leases. The weighted average interest rate was 4.86% at December 31, 2010.

Redemption of 4.90% Senior Notes due 2014 and 6.125% Senior Notes due 2019

On September 20, 2011, ITT called all of its 4.90% Senior Notes due May 2014 (the 2014 Notes) and all of its 6.125% Senior Notes due May 2019 (the 2019 Notes). The 2014 and 2019 Notes were redeemed on October 20, 2011. The redemption price for the 2014 Notes was $1,098 per $1,000 par value, plus accrued interest, and the redemption price for the 2019 Notes was $1,235 per $1,000 par value, plus accrued interest. The redemption resulted in a loss on extinguishment of $167, plus incidental fees, which was recorded as a Transformation cost.

Tender Offer for 7.40% Debentures due 2025

On September 20, 2011, we commenced a cash tender offer to purchase up to $100 in principal of our 7.40% Debentures due November 2025 (the 2025 Notes). On October 19, 2011, the tender period expired and, $88 of principal was tendered. The tender offer resulted in a loss on extinguishment of $51 which was recorded as a Transformation cost.

Following the completion of the tender offer, on October 21, 2011, we extinguished the remaining $162 of principal on the 2025 Notes pursuant to the satisfaction and discharge provisions in the indenture relating to the 2025 Notes. In order to discharge the 2025 Notes, on October 20, 2011, we deposited $6 of cash and U.S. treasury securities with an aggregate purchase price of $263 in a trust account. As a result of the satisfaction and discharge, the 2025 Notes have been extinguished for accounting purposes and are no longer presented in ITT's consolidated financial statements. The satisfaction and discharge resulted in a loss on extinguishment of approximately $107 which was recorded as a Transformation Cost.

Termination of Capital Lease

During the second quarter of 2011, we notified the lessor of our intent to terminate a sale leaseback agreement entered into in 2004 by repurchasing the leased property. The leased property includes five manufacturing and office facilities. The repurchase occurred on September 28, 2011 when ITT paid the lessor $66 million related to the capital lease obligation. The termination of the capital lease resulted in a charge of $5 which was recorded as a Transformation Cost. Four of the five properties were distributed to either Exelis or Xylem on the Distribution Date.

Other Actions Associated with Extinguishment of Debt

In connection with the debt extinguishment of $1,251, we recognized a previously deferred gain of $43 on a terminated interest rate swap and expensed previously deferred debt issuance costs and an unamortized debt discounts of $6. In addition, in September 2011 we entered into three forward-starting interest rate swaps and treasury lock to hedge certain exposure associated with the plan to extinguish the 2019 Notes and 2025 Notes. In October 2011, all four of the contracts matured and were settled in cash, resulting in a loss of $3.

NOTE 17

Postretirement Benefit Plans

In connection with the Distribution, certain pension and other employee-related benefit plans (collectively, postretirement benefit plans) were contributed by ITT to Exelis and Xylem. Exelis and Xylem assumed all assets and liabilities of the contributed plans and became the plans' sponsor on the date of the Distribution. Most significantly, Exelis became the plan sponsor of the former U.S. ITT Salaried Retirement Plan (SRP). ITT's U.S salaried employees no longer accrue retirement benefits under SRP and all benefits accrued as of the Distribution date were frozen. Benefit payments to participants in the SRP that remained ITT employees following the Distribution will be made by Exelis. During 2011, 2010, and 2009, ITT recorded expenses of approximately $15, $9 and $4, respectively, related to the participation of ITT employees in the SRP. Included in the 2011 cost of ITT participation in the SRP is a curtailment charge of approximately $1 related to the reduction in benefits, including the effect of immediate recognition of prior service costs and the impact of special termination benefits. All assets and liabilities related to postretirement benefit plans that were contributed to Exelis and Xylem, including the SRP, are reflected in discontinued operations in the consolidated financial statements.

Effective at the date of Distribution, the ITT Corporation Retirement Savings Plan for Salaried Employees was created, which increased company contributions from a maximum of 3.5% of base pay to 6% or 7%, depending on age and years of service, of total eligible pay which includes base pay, overtime and bonuses. Additionally, for five years subsequent to the distribution, the Company will provide transition credits to certain employees up to 5% of eligible pay.

Defined Contribution Plans

Substantially all of ITT's U.S. and certain international employees are eligible to participate in a defined contribution plan. ITT sponsors numerous defined contribution savings plans, which allow employees to contribute a portion of their pre-tax and/or after-tax income in accordance with specified guidelines. Several of the plans require us to match a percentage of the employee contributions up to certain limits. Company contributions charged to income amounted to $8, $7 and $5 for 2011, 2010 and 2009, respectively.

The ITT Stock Fund, an investment option under the ITT Corporation Retirement Savings Plan for Salaried Employees and the ITT Hourly Savings Plan, is considered an employee stock ownership plan and, as a result, participants in the ITT Stock Fund may receive dividends in cash or may reinvest such dividends into the ITT Stock Fund. The ITT Stock Fund held approximately 0.5 shares of ITT common stock at December 31, 2011. At the date of distribution, for each share of ITT common stock in the ITT Stock Fund, a share of common stock of each Exelis and Xylem was received. As of December 31, 2011, there were 0.4 and 1.1 shares of Exelis and Xylem, respectively, held in the ITT Corporation Retirement Savings Plan for Salaried Employees and ITT Hourly Savings Plan.

Defined Benefit Plans

ITT sponsors numerous defined benefit pension plans which have approximately 2,200 active participants, however, most of these plans have been closed to new participants for several years. As of December 31, 2011, of our total projected benefit obligation, the ITT Pension Plan for Bargaining Unit Employees Seneca Falls represented 28%, the ITT Consolidated Hourly Pension Plan represented 26%, other U.S. plans represented 30% and international pension plans represented 16%. The domestic plans are generally for hourly employees with a flat dollar benefit formula based on years of service. Foreign plan benefits are primarily determined based on participant years of service, future compensation, and age at retirement or termination.

ITT also provides health care and life insurance benefits for certain eligible U.S. employees upon retirement. In some cases, the plan is still open to new employees, but for the majority of our businesses these plans are closed to new participants. The majority of the liability pertains to retirees with postretirement medical insurance.

Balance Sheet Information

Amounts recognized as liabilities in the Consolidated Balance Sheets for postretirement benefit plans reflect the funded status. The following table provides a summary of the funded status of our postretirement benefit plans and the presentation of the funded status within our Consolidated Balance Sheet as of December 31, 2011 and 2010.

	2011			2010		
	Pension	**Other Benefits**	**Total**	Pension	Other Benefits	Total
Fair value of plan assets	**$ 184**	**$ 8**	**$ 192**	$ 187	$ 8	$ 195
Projected benefit obligation	**330**	**192**	**522**	299	175	474
Funded status	**$(146)**	**$(184)**	**$(330)**	$(112)	$(167)	$(279)
Amounts reported within:						
Accrued liabilities	**$ (4)**	**$ (10)**	**$ (14)**	$ (3)	$ (10)	$ (13)
Non-current liabilities	**(142)**	**(174)**	**(316)**	(109)	(158)	(267)

A portion of our projected benefit obligation includes amounts that have not yet been recognized as expense in our results of operations. Such amounts are recorded within accumulated other comprehensive loss until they are amortized as a component of net periodic postretirement cost. The following table provides a summary of amounts recorded within accumulated other comprehensive loss at December 31, 2011 and 2010.

	2011			2010		
	Pension	**Other Benefits**	**Total**	Pension	Other Benefits	Total
Net actuarial loss	**$147**	**$58**	**$205**	$100	$45	$145
Prior service cost (benefit)	**6**	**(1)**	**5**	9	(1)	8
Total	**$153**	**$57**	**$210**	$109	$44	$153

The following table provides a rollforward of the projected benefit obligations for our U.S. and international pension plans for the years ended December 31, 2011 and 2010.

	2011			2010		
	U.S.	**Int'l**	**Total**	U.S.	Int'l	Total
Change in benefit obligation						
Benefit obligation – January 1	**$246**	**$53**	**$299**	$229	$51	$280
Service cost	**6**	**1**	**7**	6	1	7
Interest cost	**13**	**2**	**15**	14	2	16
Amendments /other	**(2)**	**–**	**(2)**	(1)	2	1
Actuarial loss (gain)	**27**	**(1)**	**26**	10	(1)	9
Benefits paid	**(13)**	**(3)**	**(16)**	(12)	(2)	(14)
Curtailment / Special termination benefit	**1**	**–**	**1**	–	1	1
Liabilities assumed through acquisition	**–**	**1**	**1**	–	–	–
Foreign currency translation	**–**	**(1)**	**(1)**	–	(1)	(1)
Benefit obligation – December 31	**$278**	**$52**	**$330**	$246	$53	$299

The following table provides a rollforward of the projected benefit obligations for our other employee-related defined benefit plans for the years ended December 31, 2011 and 2010.

	2011	2010
Change in benefit obligation		
Benefit obligation – January 1	**$175**	$171
Service cost	**2**	2
Interest cost	**9**	9
Actuarial loss	**15**	2
Benefits paid	**(9)**	(9)
Benefit obligation – December 31	**$192**	$175

The following table provides a rollforward of the pension plan assets and the funded status for our U.S. and international pension plans for the years ended December 31, 2011 and 2010.

	2011			2010		
	U.S.	**Int'l**	**Total**	U.S.	Int'l	Total
Change in plan assets						
Plan assets – January 1	**$185**	**$ 2**	**$ 187**	$174	$ 2	$ 176
Actual return on plan assets	**(6)**		**(6)**	23	–	23
Employer contributions	**18**	**3**	**21**	2	3	5
Benefits paid	**(13)**	**(3)**	**(16)**	(12)	(3)	(15)
Expenses	**(2)**	**–**	**(2)**	(2)	–	(2)
Plan assets – December 31	**$182**	**$ 2**	**$ 184**	$185	$ 2	$ 187
Funded status at end of year	**$ (96)**	**$(50)**	**$(146)**	$ (61)	$(51)	$(112)

The following table provides a rollforward of the other employee-related defined benefit plan assets and the funded status for the years ended December 31, 2011 and 2010.

	2011	2010
Change in plan assets		
Plan assets – January 1	**$ 8**	$ 8
Employer contributions	**9**	9
Benefits paid	**(9)**	(9)
Plan assets – December 31	**$ 8**	$ 8
Funded status at end of year	**$(184)**	$(167)

The accumulated benefit obligation for all defined benefit pension plans was $328 and $297 at December 31, 2011 and 2010, respectively. The following table provides information for pension plans with an accumulated benefit obligation in excess of plan assets.

	2011	2010
Projected benefit obligation	**$328**	$299
Accumulated benefit obligation	**327**	297
Fair value of plan assets	**182**	187

Income Statement Information

The following table provides the components of net periodic benefit cost and other amounts recognized in other comprehensive income for each of the three years ended December 31, 2011, as they pertain to our defined benefit pension plans.

	2011			2010			2009		
	U.S.	**Int'l**	**Total**	U.S.	Int'l	Total	U.S.	Int'l	Total
Net periodic benefit cost									
Service cost	**$ 6**	**$ 1**	**$ 7**	$ 6	$1	$ 7	$ 4	$1	$ 5
Interest cost	**13**	**2**	**15**	14	2	16	13	3	16
Expected return on plan assets	**(19)**	**–**	**(19)**	(18)	–	(18)	(18)	–	(18)
Amortization of net actuarial loss	**4**	**–**	**4**	2	–	2	2	–	2
Amortization of prior service cost	**1**	**–**	**1**	1	–	1	1	–	1
Net periodic benefit cost (income)	**5**	**3**	**8**	5	3	8	2	4	6
Effect of curtailment / Special termination benefit	**3**	**–**	**3**	–	2	2	–	–	–
Total net periodic benefit cost (income)	**8**	**3**	**11**	5	5	10	2	4	6
Other changes in plan assets and benefit obligations recognized in other comprehensive income									
Net loss (gain)	**52**	**(1)**	**51**	5	–	5	(10)	–	(10)
Prior service cost	**–**	**–**	**–**	1	–	1	–	–	–
Amortization of net actuarial loss	**(4)**	**–**	**(4)**	(2)	–	(2)	(2)	–	(2)
Amortization of prior service cost	**(3)**	**–**	**(3)**	(1)	–	(1)	(1)	–	(1)
Total change recognized in other comprehensive (loss) income	**45**	**(1)**	**44**	3	–	3	(13)	–	(13)
Total impact from net periodic benefit cost and changes in other comprehensive (loss) income	**$ 53**	**$ 2**	**$ 55**	$ 8	$5	$ 13	$(11)	$4	$ (7)

The following table provides the components of net periodic benefit cost and other amounts recognized in other comprehensive (loss) income for each of the three years ended December 31, 2011, as they pertain to other employee-related defined benefit plans.

	2011	2010	2009
Net periodic benefit cost			
Service cost	**$ 2**	$ 2	$ 2
Interest cost	**9**	9	10
Expected return on plan assets	**(1)**	(1)	(1)
Amortization of net actuarial loss	**3**	1	2
Total net periodic benefit cost	**13**	11	13
Other changes in plan assets and benefit obligations recognized in other comprehensive (loss) income			
Net loss	**15**	2	7
Amortization of net actuarial loss	**(3)**	(1)	(2)
Total changes recognized in other comprehensive (loss) income	**12**	1	5
Total impact from net periodic benefit cost and changes in other comprehensive (loss) income	**$25**	$12	$18

The following table provides the estimated net actuarial loss and prior service cost that will be amortized from accumulated other comprehensive income into net periodic benefit cost during 2012.

	Pension	Other Benefits	Total
Net actuarial loss	$6	$4	$10
Prior service cost	1	–	1
Total	$7	$4	$11

Postretirement Plan Assumptions

The determination of projected benefit obligations and the recognition of expenses related to postretirement benefit plans are dependent on various assumptions that are judgmental and developed in consultation with external advisors. Management develops each assumption using relevant company experience in conjunction with market-related data for each individual country in which such plans exist. Assumptions are reviewed annually and adjusted as necessary. The actuarial assumptions are based on the provisions of the applicable accounting pronouncements, review of various market data and discussion with our external advisors. Changes in these assumptions could materially affect our financial position and results of operations.

The following table provides the weighted-average assumptions used to determine projected benefit obligations and net periodic postretirement cost, as they pertain to our defined benefit pension plans.

	2011		2010	
	U.S.	**Int'l**	U.S.	Int'l
Obligation Assumptions:				
Discount rate	**4.79%**	**4.85%**	5.69%	5.03%
Rate of future compensation increase	**N/A**	**2.46%**	N/A	2.42%
Cost Assumptions:				
Discount rate	**5.69%**	**5.03%**	6.00%	5.09%
Expected return on plan assets	**9.00%**	**4.75%**	9.00%	4.75%

The following table provides the weighted-average assumptions used to determine projected benefit obligations and net periodic postretirement cost, as they pertain to other employee-related defined benefit plans.

	2011	2010
Obligation Assumptions:		
Discount rate	**4.80%**	5.50%
Cost Assumptions:		
Discount rate	**5.50%**	6.00%
Expected return on plan assets	**9.00%**	9.00%

The assumed discount rates reflect our expectation of the present value of expected future cash payments for benefits at the measurement date. We base the discount rate assumption on current investment yields of high-quality fixed income securities during the retirement benefits maturity period. The discount rates were determined by considering an interest rate yield curve comprising high quality corporate bonds, with maturities between zero and thirty years. Annual benefit payments are then discounted to present value using this yield curve to develop a single-point discount rate matching the plan's characteristics.

The rate of future compensation increase assumption for foreign plans reflects our long-term actual experience and future and near-term outlook.

The expected long-term rate of return on assets reflects the expected returns for each major asset class in which the plans invest, the weight of each asset class in the target mix, the correlations among asset classes and their expected volatilities. Our expected return on plan assets is estimated by evaluating both historical returns and estimates of future returns based on our targeted asset allocation. Specifically, we estimate future returns based on independent estimates of asset class returns weighted by the targeted investment allocation.

Prior to the Distribution of Exelis and Xylem, the Company's U.S. postretirement plans participated in a master trust that invested in asset classes that historically generated asset returns in excess of the expected long-term rate of return on plan assets. With the distribution of certain postretirement benefit plans and their respective plan assets to Exelis and Xylem, we developed a new targeted asset allocation that is expected to generate a lower level of returns on plan assets than were realized in the past. Based on this approach, our weighted average estimate of the long-term annual rate of return on assets for pension plans beginning in 2012 will be reduced to 8%. For postretirement plans that participated in the master trust distributed to Exelis, the chart below shows actual returns compared to the expected long-term returns for our postretirement plans that were utilized in the calculation of the net periodic postretirement cost for each respective year.

	2011	2010	2009
Expected rate of return on plan assets	**9.00%**	9.00%	9.00%
Actual rate of return on plan assets	**(3.2)%**	14.1%	24.1%

For the recognition of net periodic postretirement cost, the calculation of the expected return on plan assets is generally derived using a market-related value of plan assets based on average asset values at the measurement date over the last five years. The use of fair value, rather than a market-related value, of plan assets could materially affect net periodic postretirement cost.

The assumed rate of future increases in the per capita cost of health care (the health care trend rate) is 7.3% for 2012, decreasing ratably to 5.0% in 2019. Increasing the health care trend rates by one percent per year would have the effect of increasing the benefit obligation by $23 and the aggregate annual service and interest cost components by $2. A decrease of one percent in the health care trend rate would reduce the benefit obligation by $19 and the aggregate annual service and interest cost components by $1. To the extent that actual experience differs from these assumptions, the effect will be amortized over the average future service of the covered active employees.

Investment Policy

The investment strategy for managing worldwide postretirement benefit plan assets is to seek an optimal rate of return relative to an appropriate level of risk for each plan. Investment strategies vary by plan, depending on the specific characteristics of the plan, such as plan size and design, funded status, liability profile and legal requirements.

Substantially all of the postretirement benefit plan assets are managed on a commingled basis in a master investment trust. With respect to the master investment trust, the Company allows itself broad discretion to invest tactically to respond to changing market conditions, while staying reasonably within the targeted asset allocation ranges prescribed by its investment guidelines. In making these asset allocation decisions, the Company takes into account recent and expected returns and volatility of returns for each asset class, the expected correlation of returns among the different investments, as well as anticipated funding and cash flows. To enhance returns and mitigate risk, the Company diversifies its investments by strategy, asset class, geography and sector.

Prior to the Distribution, the domestic postretirement benefit plan assets were included in the master investment trust that also included assets of plans contributed to Exelis and Xylem. At the distribution date, the master trust and all of its investments were transferred to Exelis and ITT received a cash contribution from Exelis proportionate to its share of investments in the master trust which was subsequently invested through a newly established master trust. At December 31, 2011, the plan assets have been invested on a temporary basis. As a result of these developments, the actual asset allocation, targeted asset allocation and mix of investments in the master trust has changed from the prior year.

The following table provides the allocation of plan assets held in the master investment trust by asset category, as of December 31, 2011 and 2010, and the related targeted asset allocation ranges by asset category.

	2011	**Targeted Allocation Range**	2010	Targeted Allocation Range
Domestic equities	**33%**	**30-40%**	25%	25-75%
Alternative investments	**0%**	**0%**	47%	20-45%
International equities	**27%**	**20-40%**	18%	10-45%
Fixed income	**35%**	**25-45%**	2%	0-60%
Cash and other	**5%**	**0-5%**	8%	0-30%

The strategies and allocations of plan assets outside of the U.S. are managed locally and may differ significantly from those in the U.S. In general and as of December 31, 2011, non-U.S. plan assets of approximately $2 million are managed closely to their strategic allocations.

Fair Value of Plan Assets

In measuring plan assets at fair value, a fair value hierarchy is applied which categorizes and prioritizes the inputs used to estimate fair value into three levels. The fair value hierarchy is based on maximizing the use of observable inputs and minimizing the use of unobservable inputs when measuring fair value. Classification within the fair value hierarchy is based on the lowest level input that is significant to the fair value measurement. The three levels of the fair value hierarchy are defined as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2 inputs are other than quoted prices included within level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices (in non-active markets or in active markets for similar assets or liabilities), inputs other than quoted prices that are observable, and inputs that are derived principally from or corroborated by observable market data by correlation or other means.
- Level 3 inputs are unobservable inputs for the assets or liabilities.

In certain instances, fair value is estimated using quoted market prices obtained from external pricing services. In obtaining such data from the pricing service, the Company has evaluated the methodologies used to develop the estimate of fair value in order to assess whether such valuations are representative of fair value, including net asset value (NAV). Additionally, in certain circumstances, the Company may adjust NAV reported by an asset manager when sufficient evidence indicates NAV is not representative of fair value.

The following is a description of the valuation methodologies and inputs used to measure fair value for major categories of investments.

- Equity securities – Equities (including common and preferred shares, domestic listed and foreign listed, closed end mutual funds and exchange traded funds) are generally valued at the closing price reported on the major market on which the individual securities are traded at the measurement date. As all equity securities held by the Company are publicly traded in active markets, the securities are classified within Level 1 of the fair value hierarchy.
- Open ended mutual funds, collective trusts and commingled funds – Open ended mutual funds, collective trusts and commingled funds are measured at NAV. These funds are generally classified within Level 2 of the fair value hierarchy.
- Private equity – The valuation of limited partnership interests in private equity funds may require significant management judgment. The NAV reported by the asset manager is adjusted when management determines that NAV is not representative of fair value. In making such an assessment, a variety of factors are reviewed by management, including, but not limited to, the timeliness of NAV as reported by the asset manager and changes in general economic and market conditions subsequent to the last NAV reported by the asset manager. These funds are generally classified within Level 3 of the fair value hierarchy.
- Absolute return (hedge funds) – The valuation of limited partnership interests in hedge funds may require significant management judgment. The NAV reported by the asset manager is adjusted when management determines that NAV is not representative of fair value. In making such an assessment, a variety of factors are reviewed by management, including, but not limited to, the timeliness of NAV as reported by the asset manager and changes in general economic and market conditions subsequent to the last NAV reported by the asset manager. Depending on how quickly ITT can redeem these investments and the extent of any adjustments to NAV, hedge funds are classified within either Level 2 (redeemable within 90 days) or Level 3 (redeemable beyond 90 days) of the fair value hierarchy.
- Fixed income – U.S. government securities are generally valued using quoted prices of securities with similar characteristics. Corporate bonds and notes are generally valued by using pricing models (e.g. discounted cash flows), quoted prices of securities with similar characteristics or broker quotes. Fixed income securities are generally classified in Level 2 of the fair value hierarchy. Other employee benefit plan assets include an investment in a structured security valued using broker quotes. Due to the significance of unobservable inputs involved in the broker quote, the investment is classified within Level 3 of the fair value hierarchy.

The following table provides the fair value of plan assets held by our postretirement benefit plans, at December 31, 2011 and 2010, by asset class.

	Pension		**Other Benefits**	
2011	**Total**	**Level 2**	**Total**	**Level 3**
Asset Category				
Equities:				
Domestic	**$ 60**	**$ 60**	**$–**	**$–**
International	**33**	**33**	**–**	**–**
Emerging Markets	**16**	**16**	**–**	**–**
Fixed income	**63**	**63**	**–**	**–**
Cash and other	**12**	**12**	**8**	**8**
Total	**$184**	**$184**	**$8**	**$8**

2010	Pension				Other Benefits	
	Total	**Level 1**	**Level 2**	**Level 3**	**Total**	**Level 3**
Asset Category						
Equities:						
Domestic	$ 47	$36	$ 7	$ 4	$–	$–
International	15	10	–	5	–	–
Emerging Markets	19	8	9	2	–	–
Private equity[(a)]	55	–	7	48	–	–
Absolute return (hedge funds) [(b)]	32	–	12	20	–	–
Commodities, fixed income and other	19	–	16	3	8	8
Total	$187	$54	$51	$82	$8	$8

(a) Private equity includes a diversified range of strategies, including buyout funds, distressed funds, venture and growth equity funds and mezzanine funds.

(b) Absolute return hedge funds primarily include fund of funds that invest in a diversified portfolio of other hedge funds that employ a range of investment strategies and fixed income/multi-strategy absolute return funds, which invest in multiple investment strategies with the intent of diversifying risk and reducing volatility.

The following table presents a reconciliation of the beginning and ending balances of fair value measurement within our pension plans using significant unobservable inputs (Level 3).

	Equity Securities	Private Equity	Absolute Returns	Commodities, Fixed Income and Other	Total
Level 3 balance – December 31, 2009	$ 9	$ 47	$ 21	$ 2	$ 79
Realized gains (losses), net	–	4	–	–	4
Unrealized gains (losses), net	2	2	1	–	5
Purchases/(sales), net	–	–	(2)	1	(1)
Transfers in (out), net	–	(5)	–	–	(5)
Level 3 balance – December 31, 2010	11	48	20	3	82
Realized gains (losses), net	**(1)**	**3**	**–**	**–**	**2**
Unrealized gains (losses), net	**–**	**–**	**–**	**–**	**–**
Purchases/(sales) and settlements, net	**(10)**	**(51)**	**(20)**	**(3)**	**(84)**
Transfers in (out), net	**–**	**–**	**–**	**–**	**–**
Level 3 balance – December 31, 2011	**$ –**	**$ –**	**$ –**	**$ –**	**$ –**

There have been no significant realized or unrealized gains and losses, purchases, sales or transfers of assets within our other employee-related benefit plans measured using significant unobservable inputs (Level 3).

Contributions

Funding requirements under IRS rules are a major consideration in making contributions to our post-retirement plans. With respect to qualified pension plans, we intend to contribute annually not less than the minimum required by applicable law and regulations. In addition, we fund certain of our international pension plans in countries where funding is allowable and tax-efficient. We made contributions of $21 and $5 to pension plans during 2011 and 2010, respectively. We anticipate making contributions to our global pension plans of $20 to $25 during 2012, of which $2 has been made in the first quarter.

Estimated Future Benefit Payments

The following table provides the projected timing of payments for benefits earned to date and the expectation that certain future service will be earned by current active employees for our pension and other employee-related benefit plans.

	U.S. Pension	Int'l Pension	Other Benefits
2012	$15	$ 3	$11
2013	15	3	11
2014	16	4	11
2015	16	4	12
2016	17	4	12
2017 – 2021	$93	$17	$61

NOTE 18

Long-Term Incentive Employee Compensation

Our long-term incentive awards program historically has comprised three components: non-qualified stock options (NQOs), restricted shares and units (RS) and a target cash award (TSR). We account for NQOs and RS as equity-based compensation awards. TSR awards are cash settled and accounted for as liability-based compensation.

The 2011 Omnibus Incentive Plan (2011 Incentive Plan) was approved by shareholders and established in May of 2011 to provide for the awarding of options on common shares and full value restricted common shares or units to employees and non-employee directors. The number of shares initially available for issuance to participants under the 2011 Incentive Plan was 4.6. The 2011 Incentive Plan replaced the 2003 Incentive Plan on a prospective basis and no future grants will be made under the ITT Amended and Restated 2003 Equity Incentive Plan (2003 Incentive Plan). However, any shares remaining available for issuance under the 2003 Incentive Plan as of the date of 2011 Incentive Plan shareholder approval became available for grant under the 2011 Incentive Plan. In connection with the Distribution, and per the terms of the 2011 Incentive Plan, an equitable adjustment which preserved the intrinsic value of the awards after giving effect to the distribution of Exelis and Xylem was made (referred to as the Equitable Adjustment). As of December 31, 2011, 41.1 shares were available for future grants under the 2011 Incentive Plan. ITT makes shares available for the exercise of stock options or vesting of restricted shares or units by purchasing shares in the open market or by issuing shares from treasury stock.

Long-term incentive employee compensation costs are primarily recorded within general and administrative expenses, and are reduced by an estimated forfeiture rate. These costs impacted our consolidated results of operations as follows:

	2011(a)	2010	2009
Share-based compensation expense, equity-based awards	**$23**	$14	$16
Share-based compensation expense, liability-based awards	**2**	(4)	2
Total share-based compensation expense in operating income (loss)	**25**	10	18
Tax benefit	**8**	3	6
Share-based compensation expense, net of tax	**$17**	$ 7	$12

(a) Share-based compensation expense incurred during 2011 includes $13 classified as a Transformation cost in the Consolidated Income Statement related to the modification of equity awards.

At December 31, 2011, there was $22 of total unrecognized compensation cost related to non-vested awards. This cost is expected to be recognized ratably over a weighted-average period of 2.44 years.

Conversion and Cancellation of Outstanding Equity at Spin Date

In connection with the Distribution, ITT modified its outstanding equity awards on October 31, 2011 (the modification date). For equity awards issued through employee compensation arrangements, the awards were generally modified such that, following the Distribution, the employee only held equity in their future employer and the intrinsic value of the awards was preserved through the Equitable Adjustment. Awards held by members of the Board of Directors were modified so that the awardee continued to hold an award in each of the three companies following the Distribution.

As a result of the Equitable Adjustment, an option modification expense of $9 was recorded for awards that were fully vested on the modification date, and an addition $1 of incremental fair value will be recorded in future periods as unvested awards vest. A portion of the option modification charge was allocated to discontinued operations for employees who transferred to Exelis or Xylem. Further, subsequent to the Distribution, ITT will only recognize compensation cost for awards that were unvested on the modification date for employees who remained with ITT.

Pursuant to the completion of the Distribution on October 31, 2011, 1.2 stock options and 0.5 restricted equity awards held by the employees of Exelis and Xylem were converted to equity awards in the underlying common stock of their respective employer and were cancelled as ITT equity awards.

Non-Qualified Stock Options

Options generally vest over or at the conclusion of a three-year period and are exercisable in seven or ten-year periods, except in certain instances of death, retirement or disability. Options granted between 2004 and 2009 were awarded with a contractual term of seven years. Options granted prior to 2004 and during 2010 and 2011 were awarded with a contractual term of ten years. The exercise price per share is the fair market value of the underlying common stock on the date each option is granted.

A summary of the status of our NQOs as of December 31, 2011, 2010 and 2009 and changes during the years then ended is presented below.

	2011		2010		2009	
STOCK OPTIONS	**SHARES**	**WEIGHTED-AVERAGE EXERCISE PRICE**	SHARES	WEIGHTED-AVERAGE EXERCISE PRICE	SHARES	WEIGHTED-AVERAGE EXERCISE PRICE
Outstanding – January 1	**3.7**	**$ 85.08**	4.0	$ 80.58	4.1	$79.66
Granted	**0.3**	**115.36**	0.4	106.60	0.4	67.18
Exercised	**(0.7)**	**76.27**	(0.6)	62.90	(0.4)	52.64
Cancelled or expired[(a)]	**(1.3)**	**92.76**	(0.1)	97.56	(0.1)	91.88
Outstanding on Distribution Date before Equitable Adjustment	**2.0**	**88.52**	–	–	–	–
Outstanding on Distribution Date after Equitable Adjustment	**8.0**	**16.18**	–	–	–	–
November/December 2011 Activity:						
Granted	**0.7**	**20.28**	–	–	–	–
Exercised	**(0.7)**	**13.87**	–	–	–	–
Outstanding – December 31	**8.0**	**$ 16.70**	3.7	$ 85.08	4.0	$80.58
Options exercisable – December 31	**6.3**	**$ 16.03**	3.0	$ 83.72	3.2	$78.98

(a) Includes 1.2 shares cancelled in connection with the Distribution of Exelis and Xylem, with a corresponding weighted average exercise price of $92.20.

The intrinsic value of options exercised (which is the amount by which the stock price exceeded the exercise price of the options on the date of exercise) during 2011, 2010 and 2009 was $30, $22 and $18, respectively.

The amount of cash received from the exercise of stock options was $62, $35 and $20 for 2011, 2010 and 2009, respectively. The income tax benefit realized during 2011, 2010 and 2009 associated with stock option exercises and lapses of restricted stock was $17, $14 and $11, respectively. We classify the cash flows attributable to excess tax benefits arising from stock option exercises and restricted stock lapses as a financing activity. Excess tax benefits arising from stock option exercises and restricted stock lapses were $7, $6 and $3 for 2011, 2010 and 2009, respectively. The following table summarizes information about ITT's stock options at December 31, 2011:

	OPTIONS OUTSTANDING				OPTIONS EXERCISABLE			
RANGE OF EXERCISE PRICES	NUMBER	WEIGHTED-AVERAGE REMAINING CONTRACTUAL LIFE (IN YEARS)	WEIGHTED-AVERAGE EXERCISE PRICE	AGGREGATE INTRINSIC VALUE	NUMBER	WEIGHTED-AVERAGE REMAINING CONTRACTUAL LIFE (IN YEARS)	WEIGHTED-AVERAGE EXERCISE PRICE	AGGREGATE INTRINSIC VALUE
$5-$10	0.2	(b)	$ 9.46	$ 2	0.2	(b)	$ 9.46	$ 2
$10-$15	2.9	2.2	12.98	18	2.6	1.9	13.04	16
$15-$20	3.3	1.9	18.21	5	3.0	1.2	18.02	5
$20-$26	1.6	7.2	21.19	–	0.5	2.2	22.04	–
	8.0	3.0	$16.70	$25	6.3	1.6	$16.03	$23

(b) The contractual life of the 0.2 options ended on January 2, 2012.

The aggregate intrinsic value in the preceding table represents the total pre-tax intrinsic value, based on ITT's closing stock price of $19.33 as of December 31, 2011, which would have been received by the option holders had all option holders exercised their options as of that date. The number of options "out-of-the-money" as of December 31, 2011, included as exercisable in the preceding table was 1.7.

As of December 31, 2011, the total number of stock options expected to vest (including those that have already vested) was 7.9. These stock options have a weighted-average exercise price of $16.65, an aggregate intrinsic value of $25 and a weighted-average remaining contractual life of 2.9 years.

The fair value of each option grant was estimated on the date of grant using the binomial lattice pricing model which incorporates multiple and variable assumptions over time, including assumptions such as employee exercise patterns, stock price volatility and changes in dividends. The following are weighted-average assumptions for 2011, 2010 and 2009:

	November 7, 2011 Grants	**2011 Grants Before Distribution**	2010	2009
Dividend yield	**1.79%**	**1.73%**	1.88%	2.54%
Expected volatility	**39.30%**	**24.74%**	27.06%	38.77%
Expected life (in years)	**7.0**	**7.0**	7.0	4.7
Risk-free rates	**1.51%**	**3.05%**	3.06%	2.20%
Weighted-average grant date fair value	**$ 6.97**	**$29.70**	$29.00	$19.20

Expected volatilities for option grants prior to the Distribution were based on ITT's stock price history, including implied volatilities from traded options on our stock. Expected volatilities for option grants subsequent to the Distribution were based on a peer average of historical and implied volatility. ITT uses historical data to estimate option exercise and employee termination behavior within the valuation model. Employee groups and option characteristics are considered separately for valuation purposes. The expected life represents an estimate of the period of time options are expected to remain outstanding. The expected life provided above represents the weighted average of expected behavior for certain groups of employees who have historically exhibited different behavior. The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of option grant.

Restricted Stock

RS typically vests three years from the date of grant. Holders of restricted shares have the right to receive dividends and vote on the shares. Holders of restricted units have the right to receive cumulative dividends, which are subject to forfeiture, at the vesting date. If an employee leaves the Company prior to vesting, whether through resignation or termination for cause, the RS is forfeited. If an employee retires or is terminated other than for cause, a pro rata portion of the RS may vest. Included within restricted stock outstanding are 0.1 vested shares that have been deferred until termination of service per individual award agreements. As of December 31, 2011, the total number of RS expected to vest was 1.3.

The table below provides a rollforward of outstanding RS for each of the previous three years ended.

	2011		2010		2009	
RESTRICTED STOCK	**SHARES**	**WEIGHTED-AVERAGE GRANT DATE FAIR VALUE**	SHARES	WEIGHTED-AVERAGE GRANT DATE FAIR VALUE	SHARES	WEIGHTED-AVERAGE GRANT DATE FAIR VALUE
Outstanding – January 1	**0.9**	**$ 89.70**	0.8	$ 88.72	0.7	$103.92
Granted	**0.3**	**115.18**	0.3	106.50	0.3	67.76
Lapsed	**(0.3)**	**99.53**	(0.2)	108.88	(0.2)	105.66
Cancelled(c)	**(0.6)**	**95.30**	–	89.50	–	109.88
Outstanding on Distribution Date before equitable adjustment	**0.3**	**93.42**	–	–	–	–
Outstanding on Distribution Date after equitable adjustment	**1.0**	**17.94**	–	–	–	–
November/December 2011 Activity:						
Granted	**0.4**	**20.27**	–	–	–	–
Outstanding – December 31	**1.4**	**$ 18.55**	0.9	$ 89.62	0.8	$ 88.72

(c) Includes 0.5 RS cancelled in connection with the Distribution of Exelis and Xylem, with a corresponding weighted average grant date fair value of $95.14.

Restricted units represented approximately 63%, 21% and 19% of total RS outstanding at December 31, 2011, 2010 and 2009, respectively.

Total Shareholder Return Awards

The TSR award plan is a performance-based cash award incentive program provided to key employees of ITT. TSR awards are accounted for under stock-compensation principles of accounting as liability-based awards. The fair value of outstanding awards is determined at the conclusion of the three-year performance period by measuring ITT's total shareholder return percentage against the total shareholder return performance of other stocks generally comprising the S&P Industrials Index. We reassess the fair value of our TSR awards on a quarterly basis at the end of each reporting period using actual total shareholder return data over the elapsed performance period as well as a Monte Carlo simulation. Payment, if any, typically occurs during the first quarter of each year and is based on the TSR performance comparison measured against targets established at the time of the award. However, no payments were made during 2011 as the TSR performance metric for the 2008 to 2010 performance period was less than the minimum stipulated in the TSR Award Agreement. During 2010 and 2009, payments totaling $18 and $21 were made to settle the vested 2007 and 2006 TSR awards, respectively.

In connection with the Distribution, a proportionate number of outstanding TSR awards vested corresponding to the percentage of time passed between original grant date and October 31, 2011 (the vested portion). The fair value of the vested portion on October 31, 2011 was nil, as the performance factor for each TSR grant was below the floor threshold. The unvested portion of TSR awards (the percent of time remaining between October 31, 2011 and the awards originally stated vest end date) were modified depending on the year of grant. The 2009 TSR awards were modified to settle via a cash payment in December 2011 of less than $1, equal to the unvested portion at target payout of 100%. The unvested portion of the 2010 and 2011 TSR awards were modified through the granting of RSU awards with a grant date fair value equal to the unvested portion at target. The replacement RSU awards maintain the vesting date established in the original TSR award agreement. No compensation expense was recognized in connection with these modifications as the incremental fair value resulting from the modification pertains to the unvested portion of the original TSR award. The deferred compensation cost of $2 will be recognized straight-line over the remaining vesting periods.

NOTE 19

Capital Stock

ITT has authority to issue an aggregate of 300 shares of capital stock, of which 250 shares have been designated as "Common Stock" having a par value of $1 per share and 50 shares have been designated as "Preferred Stock" not having any par or stated value. There was no Preferred Stock outstanding as of December 31, 2011 and 2010.

The stockholders of ITT common stock are entitled to receive dividends when and as declared by ITT's Board of Directors. Dividends are paid quarterly. Dividends declared were $1.591, $2.00 and $1.70 per common share in 2011, 2010, and 2009, respectively.

On October 27, 2006, a three-year $1 billion share repurchase program was approved by our Board of Directors. On December 16, 2008, the provisions of the share repurchase program were modified by our Board of Directors to replace the original three-year term with an indefinite term. Through December 2008, we had repurchased 3.6 million shares for $431, including commission fees, under the $1 billion share repurchase program. No shares have been repurchased since December 2008.

We make shares available for the exercise of stock options and vesting of restricted stock by purchasing shares in the open market or by issuing shares from treasury stock. During 2011, we issued 0.8 shares from our treasury account related to equity compensation arrangements. As of December 31, 2011 and 2010, 10.6 and 11.5 shares of Common Stock were held in our treasury account, respectively.

On October 31, 2011, the distribution of Exelis and Xylem from ITT was completed. On October 31, 2011, the stockholders of record as of the Record Date received one share of Xylem common stock and one share of Exelis common stock for each share of ITT common stock held as of the Record Date. The Distribution was completed pursuant to a Distribution Agreement, effective as of October 25, 2011, among ITT, Exelis and Xylem.

On October 31, 2011, we completed the 1:2 Reverse Stock Split. The par value of our common stock remained $1 per share following the 1:2 Reverse Stock Split. All preferred and common stock shares available, issued and outstanding, as well as share prices and earnings per share give effect to the 1:2 Reverse Stock Split in all periods presented. Cash payments made to settle fractional shares resulting from the 1:2 Reverse Stock Split were immaterial.

NOTE 20

Commitments and Contingencies

From time to time we are involved in legal proceedings that are incidental to the operation of our businesses. Some of these proceedings allege damages relating to asbestos liabilities, environmental liabilities, intellectual property matters, copyright infringement, personal injury claims, employment and pension matters and commercial or contractual disputes, sometimes related to acquisitions or divestitures. We will continue to defend vigorously against all claims. Although the ultimate outcome of any legal matter cannot be predicted with certainty, based on present information including our assessment of the merits of the particular claim, as well as our current reserves and insurance coverage, we do not expect that such legal proceedings will have any material adverse impact on our cash flow, results of operations, or financial position on a consolidated basis, unless otherwise noted below.

Asbestos Matters

Background

ITT, including its subsidiary Goulds Pumps, Inc., has been joined as a defendant with numerous other companies in product liability lawsuits alleging personal injury due to asbestos exposure. These claims allege that certain products sold by us or our subsidiaries prior to 1985 contained a part manufactured by a third party (e.g., a gasket) which contained asbestos. To the extent these third-party parts may have contained asbestos, it was encapsulated in the gasket (or other) material and was non-friable. In certain other cases, it is alleged that former ITT companies were distributors for other manufacturers' products that may have contained asbestos.

As of December 31, 2011, there were 105,486 open claims against ITT filed in various state and federal courts alleging injury as a result of exposure to asbestos. Activity related to these asserted asbestos claims during the period was as follows:

	2011	2010[(b)]	2009
Pending claims[(a)] – January 1	**103,575**	104,679	103,006
New claims	**5,691**	5,865	4,274
Settlements	**(1,426)**	(991)	(1081)
Dismissals	**(2,354)**	(6,469)	(4,728)
Adjustment[(c)]	**–**	491	3,208
Pending claims[(a)] – December 31	**105,486**	103,575	104,679

(a) Excludes 34,869 claims related to maritime actions, almost all of which were filed in the United States District Court for the Northern District of Ohio, because the Company believed they would not be litigated. In August 2010, these cases were dismissed.

(b) In September 2010, ITT executed an amended cost-sharing agreement related to a business we disposed of a number of years ago. The cost sharing agreement provides that responsibility for costs associated with claims resolved gradually transitions away from ITT, such that ITT will have no responsibility for claims resolved beginning no later than July 1, 2022. The table above excludes claim activity associated with the amended cost-sharing agreement for claims that were not filed against ITT.

(c) Reflects an adjustment to increase the number of open claims as a result of transitioning claims data from our primary insurance carriers to a third party claims administrator.

At December 31, 2011, the jurisdictions with highest pending claims counts against ITT include Mississippi (approximately 40,000 claims), New York (approximately 30,000 claims), and Florida (approximately 7,000 claims).

Frequently, plaintiffs are unable to identify any ITT or Goulds Pumps product as a source of asbestos exposure. In addition, in a large majority of claims pending against the Company, plaintiffs are unable to demonstrate any injury. Many of those claims have been placed on inactive dockets (including 39,604 claims in Mississippi). Our experience to date is that a substantial portion of resolved claims have been dismissed without payment by the Company. As a result, management believes that a large majority of the pending claims have little or no value. The average cost per claim, including indemnity and defense costs, resolved in 2011 and 2010 was $19 thousand and $7 thousand, respectively. Because claims are sometimes dismissed in large groups, the average cost per resolved claim can fluctuate significantly from period to period.

The Company records an asbestos liability, including legal fees, for costs that the Company is estimated to incur to resolve all pending claims, as well as unasserted claims estimated to be filed over the next 10 years. The asbestos liability has not been discounted to present value due to the inability to reliably forecast the timing of future cash flows. The methodology used to estimate our liability for pending and asbestos claims estimated to be filed over the next 10 years relies on and includes the following:

- interpretation of a widely accepted forecast of the population likely to have been occupationally exposed to asbestos;
- widely accepted epidemiological studies estimating the number of people likely to develop mesothelioma and lung cancer from exposure to asbestos;
- the Company's historical experience with the filing of non-malignant claims against it and the historical relationship between non-malignant and malignant claims filed against the Company;
- analysis of the number of likely asbestos personal injury claims to be filed against the Company based on such epidemiological and historical data and the Company's recent claims experience;
- analysis of the Company's pending cases, by disease type;
- analysis of the Company's recent experience to determine the average settlement value of claims, by disease type;
- analysis of the Company's defense costs in relation to its indemnity costs and resolved claims;
- adjustment for inflation in the future average settlement value of claims and defense costs; and
- analysis of the Company's recent experience with regard to the length of time to resolve asbestos claims.

The forecast period used to estimate our potential exposure to pending and projected asbestos claims is a judgment based on a number of factors, including the number and type of claims filed, recent experience with pending claims activity and whether that experience will continue into the future, the jurisdictions where claims are filed, the effect of any legislative or judicial developments, and the likelihood of any comprehensive asbestos legislation at the federal level. These factors have both positive and negative effects on the dynamics of asbestos litigation in the tort system and, accordingly, our estimate of the asbestos exposure. Developments related to asbestos tend to be long-cycle, changing over multi-year periods. Accordingly, we monitor these and other factors and periodically assess whether an alternative forecast period is appropriate.

The Company retains a consulting firm to assist management in estimating the potential liability for pending asbestos claims and for claims estimated to be filed over the next 10 years based on the methodology described above. Our methodology determines a point estimate based on our assessment of the value of each underlying assumption, rather than a range of reasonably possible outcomes. Projecting future asbestos costs is subject to numerous variables and uncertainties that are inherently difficult to predict. In addition to the uncertainties surrounding the key assumptions discussed above, additional uncertainty related to asbestos claims and estimated costs arises from the long latency period prior to the manifestation of an asbestos-related disease, changes in available medical treatments and changes in medical costs, changes in plaintiff behavior resulting from bankruptcies of other companies that are potential or co-defendants, uncertainties surrounding the litigation process from jurisdiction to jurisdiction and from case to case, and the impact of potential legislative or judicial changes.

We record a corresponding asbestos-related asset that represents our best estimate of probable recoveries from insurers and other responsible parties for the estimated asbestos liabilities. In developing this estimate, the Company considers coverage-in-place and other settlement agreements with its insurers and contractual agreements with other responsible parties, as well as a number of additional factors. These additional factors reviewed include current levels of future cost recovery, the financial viability of the insurance companies or other responsible parties, the method by which losses will be allocated to the various insurance policies and the years covered by those policies, the extent to which settlement and defense costs will be reimbursed by the insurance policies, and interpretation of the various policy and contract terms and limits and their interrelationships. The timing and amount of reimbursements will vary due to the lag between when ITT pays an amount to defend or settle a claim and when a reimbursement is received, differing policy terms, and certain gaps in our insurance coverage as a result of uninsured periods, insurer insolvencies, and prior insurance settlements. In addition, the Company retains an insurance consulting firm to assist management in estimating probable recoveries for pending asbestos claims and for claims estimated to be filed over the next 10 years based on the analysis of policy terms, the likelihood of recovery provided by external legal counsel assuming the continued viability of those insurance carriers and other responsible parties that are currently solvent, and incorporating risk mitigation judgments where policy terms or other factors are not certain, and allocating asbestos settlement and defense costs between our insurers and other responsible parties.

The Company has negotiated with certain of its insurers and other responsible parties to reimburse the Company for a portion of its settlement and/or defense costs as incurred through "coverage-in-place" agreements, policy buyout and settlement agreements and a cost sharing agreement which provides that responsibility for costs associated with claims resolved gradually transitions away from ITT, such that ITT will have no responsibility for claims resolved beginning no later than July 1, 2022. These agreements, in the aggregate, represent approximately 60% of the recorded asbestos-related asset.

Estimating our exposure to pending asbestos claims and those that may be filed in the future is subject to significant uncertainty and risk as there are multiple variables that can affect the timing, severity, quality, quantity and resolution of claims. Any predictions with respect to the variables impacting the estimate of the asbestos liability and related asset are subject to even greater uncertainty as the projection period lengthens. In light of the uncertainties and variables inherent in the long-term projection of the Company's asbestos exposures, although it is probable that the Company will incur additional costs for asbestos claims filed beyond the next 10 years which could be material, we do not believe there is a reasonable basis for estimating those costs at this time.

Income Statement Charges

In the third quarter, we conduct an annual study with the assistance of outside consultants to review and update the underlying assumptions used in our asbestos liability and related asset estimates. During this study, the underlying assumptions are updated based on our actual experience since our last annual study, a reassessment of the appropriate reference period of years of experience used in determining each assumption and our expectations regarding future conditions, including inflation. Based on the results of this study, we adjusted our estimated undiscounted asbestos liability, including legal fees, by ($44), $691 and $708, in 2011, 2010 and 2009, respectively. These charges reflect costs that the Company is estimated to incur to resolve all pending claims, as well as unasserted claims estimated to be filed over the next 10 years. The increase in our estimated liability in the third quarter of 2011 was a result of several developments, including a reduction in the assumed rate of increase in future average settlement costs and an expectation of lower defense costs relative to indemnities paid. These favorable factors were offset in part by increased activity in several higher-cost jurisdictions, increasing the number of cases expected to be adjudicated. The increase in our estimated liability in the third quarter of 2010 was a result of several developments, including higher settlement costs and significantly increased activity in several higher-cost jurisdictions, increasing the number of cases to be adjudicated and the expected legal costs. The increase in our estimated liability in the third quarter of 2009 was a result of recording an estimated liability to claims estimated to be filed. Prior to 2009, the Company only recorded a liability for pending asbestos claims due to the inability to estimate the potential exposure.

Further, in the third quarter of 2011 the Company recorded a $76 reduction in its asbestos-related assets based on the results of the annual studies, whereas in the third quarter 2010 and 2009 the Company increased its asbestos-related asset by $371 and $485, respectively. These assets comprise an insurance asset, as well as receivables from other responsible parties. See discontinued operations discussion below for further information about receivables from parties other than insurers.

In addition to charges associated with the annual reassessment, beginning in the fourth quarter of 2009, the Company also records a net asbestos charge each quarter to maintain a rolling 10 year forecast period.

For the years ended December 31, 2011, 2010 and 2009, the income statement effects of asbestos charges consisted of the following:

For the Year Ended December 31, 2011	**Continuing Operations**			**Discontinued Operations**			
	Liability	**Asset**	**Net**	**Liability**	**Asset**	**Net**	**Total**
Provision	**$ 85**	**$26**	**$ 59**	**$ 24**	**$ 21**	**$ 3**	**$ 62**
Remeasurement	**38**	**(3)**	**41**	**(82)**	**(73)**	**(9)**	**32**
Asbestos-related costs before tax	**$123**	**$23**	**100**	**$(58)**	**$(52)**	**(6)**	**94**
Tax benefit			**(37)**			**2**	**(35)**
Asbestos-related costs, net of tax			**$ 63**			**$(4)**	**$ 59**

For the Year Ended December 31, 2010	Continuing Operations			Discontinued Operations			
	Liability	Asset	Net	Liability	Asset	Net	Total
Provision	$ 67	$ 12	$ 55	$ 50	$ 50	$ –	$ 55
Remeasurement	524	194	330	167	177	(10)	320
Asbestos-related costs before tax	$591	$206	385	$217	$227	(10)	375
Tax benefit			(144)			4	(140)
Asbestos-related costs, net of tax			$ 241			$ (6)	$ 235

For the Year Ended December 31, 2009	Continuing Operations			Discontinued Operations			
	Liability	Asset	Net	Liability	Asset	Net	Total
Provision	$ 56	$ 28	$ 28	$ 2	$ 6	$ (4)	$ 24
Remeasurement	644	434	210	64	51	13	223
Asbestos-related costs before tax	$700	$462	238	$66	$57	9	247
Tax benefit			(95)			(3)	(98)
Asbestos-related costs, net of tax			$143			$ 6	$149

Changes in Financial Position:

The Company's estimated asbestos exposure, net of expected recoveries from insurers and other responsible parties, for the resolution of all pending claims and claims estimated to be filed in the next 10 years was $714 and $641 as of December 31, 2011 and 2010, respectively. The following table provides a rollforward of the estimated total asbestos liability and related assets for the years ended December 31, 2011 and 2010, respectively.

	2011			2010		
	Liability	**Asset**	**Net**	Liability	Asset	Net
Balance as of January 1	**$ 1,676**	**$1,035**	**$ 641**	$ 933	$ 667	$ 266
Changes in estimate during the period:						
Continuing operations	**123**	**23**	**100**	591	206	385
Discontinued operations	**(58)**	**(52)**	**(6)**	217	227	(10)
Cash activity	**(73)**	**(52)**	**(21)**	(54)	(54)	–
Other adjustments	**–**	**–**	**–**	(11)	(11)	–
Balance as of December 31	**$1,668**	**$ 954**	**$714**	$1,676	$1,035	$641
Current portion	**139**	**133**	**6**	117	105	12
Noncurrent portion	**1,529**	**821**	**708**	1,559	930	629

The asbestos liability and related receivables are based management's best estimate of future events. However, future events affecting the key factors and other variables for either the asbestos liability or the related receivables could cause actual costs and recoveries to be materially higher or lower than currently estimated. Due to these uncertainties, as well as our inability to reasonably estimate any additional asbestos liability for claims which may be filed beyond the next 10 years, it is not possible to predict the ultimate outcome of the cost of resolving all pending and estimated unasserted asbestos claims. We believe it is possible that future events affecting the key factors and other variables within the next 10 years, as well as the cost of asbestos claims filed beyond the next 10 years, net of expected recoveries, could have a material adverse effect on our financial position, results of operations and cash flows.

Discontinued Operations:
At December 31, 2011 and 2010, $234 and $292 of the asbestos liability and $233 and $285 of the related asset, respectively, related to a business which we disposed of a number of years ago that is reported as a discontinued operation. The liability and asset is subject to an amended cost-sharing agreement that was executed in September 2010 with the entity that acquired the disposed business. The amended agreement provides for a sharing of the claims settled between 2010 and 2019 naming ITT or the entity which acquired the disposed business. In future years, the liability for sharing the claims gradually transitions away from ITT, such that ITT will have no responsibility for claims resolved beginning no later than July 1, 2022. The amended cost-sharing agreement also provides for the sharing of certain insurance policies. Prior to executing the amended cost-sharing agreement in September 2010, we recorded a liability for this discontinued operation based on pending claims and unasserted claims estimated to be filed over the next 10 years against ITT. As part of amending the cost-sharing agreement, ITT was provided with the key data necessary to estimate the exposure related to the shared pending and estimated future claims. The estimate of the additional liability and asset recorded as a result of the amended cost-sharing agreement in 2010 was calculated in a manner consistent with the approach used to estimate ITT's stand-alone asbestos liabilities and assets.

Future Cash Flows:
Using the estimated liability as of December 31, 2011 (for claims filed or estimated to be filed through 2021), we have estimated that we will be able to recover 57% of the asbestos indemnity and defense costs for pending claims as well as unasserted claims estimated to be filed over the next 10 years from our insurers or other responsible parties. However, there is uncertainty in estimating when cash payments related to the recorded asbestos liability will be fully expended and such cash payments will continue for a number of years past 2021 due to the significant proportion of future claims included in the estimated asbestos liability and the lag time between the date a claim is filed and when it is resolved. In addition, because there are gaps in our insurance coverage, reflecting uninsured periods, the insolvency of certain insurers and prior insurance settlements, and our expectation that certain policies from some of our primary insurers will exhaust within the next 10 years, actual insurance reimbursements vary from period to period and the anticipated recovery rate is expected to decline over time. Future recoverability rates may be impacted by other factors, such as future insurance settlements, insolvencies and judicial determinations relevant to our coverage program, which are difficult to predict and subject to a high degree of uncertainty.

Subject to these inherent uncertainties, it is expected that future annual cash payments, net of recoveries related to pending claims and unasserted claims to be filed within the next 10 years, will extend through approximately 2026 due to the length of time between the filing of a claim and its resolution. Certain of our primary coverage in place agreements are expected to exhaust in the next twelve months, which will result in higher net cash outflows for the short-term. These annual net cash outflows are projected to average $10 to $20, net of tax benefits over the next five years, as compared to an average of approximately $6, net of tax benefits in the past three years, and increase to an average of approximately $35 to $45, net of tax over the remainder of the projection period. Recovery rates for the tenth year of our model are currently projected to be approximately 27% of cash spent on settlements and defense costs.

Environmental
In the ordinary course of business, we are subject to federal, state, local, and foreign environmental laws and regulations. We are responsible, or are alleged to be responsible, for ongoing environmental investigation and remediation of sites in various countries. These sites are in various stages of investigation and/or remediation and in many of these proceedings our liability is considered de minimis. We have received notification from the U.S. Environmental Protection Agency, and from similar state and foreign environmental agencies, that a number of sites formerly or currently owned and/or operated by ITT, and other properties or water supplies that may be or have been impacted from those operations, contain disposed or recycled materials or wastes and require environmental investigation and/or remediation. These sites include instances where we have been identified as a potentially responsible party under federal and state environmental laws and regulations.

Accruals for environmental matters are recorded on a site by site basis when it is probable that a liability has been incurred and the amount of the liability can be reasonably estimated, based on current law and existing technologies. Our accrued liabilities for environmental matters represent management's estimate of undiscounted costs to be incurred related to environmental assessment or remediation efforts, as well as related legal fees. These estimates, and related accruals, are reviewed quarterly and adjusted for progress of investigation and remediation efforts as additional technical or legal information become available.

Environmental remediation reserves are subject to numerous inherent uncertainties that affect our ability to estimate our share of the costs. Such uncertainties involve incomplete information regarding particular sites and other potentially responsible parties, uncertainty regarding the nature and extent of contamination at each site, the extent of remediation required under existing regulations, our share, if any, of any remediation liability, widely varying cost estimates associated with potential alternative remedial approaches, the length of time required to remediate a particular site, the potential effects of continuing improvements in remediation technology, and changes in environmental standards and regulatory requirements.

The following table illustrates the activity related to our accrued liabilities for environmental matters.

	2011	2010
Environmental liability – January 1	**$100**	$101
Accruals added during the period	**–**	–
Change in estimates for pre-existing accruals	**13**	10
Payments	**(11)**	(11)
Environmental liability – December 31	**$102**	$100

The following table illustrates the reasonably possible low- and high end range of estimated liability, and number of active sites for environmental matters.

	2011	2010
Low-end range	**$ 81**	$ 82
High end range	**$175**	$180
Number of active environmental investigation and remediation sites	**64**	65

While actual costs to be incurred at identified sites in future periods may vary from our current estimates given the inherent uncertainties in evaluating environmental exposures, we do not anticipate changes in our estimated liabilities for identified sites will have a material adverse effect on our consolidated financial position, results of operations or cash flows.

Other Matters

The Company is involved in coverage litigation with various insurers seeking recovery of costs incurred in connection with certain environmental and product liabilities. In a suit filed in 1991, ITT Corporation, et al. v. Pacific Indemnity Corporation et al, Sup. Ct., Los Angeles County, we are seeking recovery of costs related to environmental losses. Discovery, procedural matters, changes in California law, and various appeals have prolonged this case. For several years, the case was on appeal before the California Court of Appeals from a decision by the California Superior Court dismissing certain claims made by ITT. In 2011, ITT filed a Motion for Summary Judgment on PEIC's obligation to pay defense costs. That motion is currently pending before the court. Mandatory settlement conferences are anticipated to be held later this year.

On February 13, 2003, we commenced an action, Cannon Electric, Inc. v. Affiliated FM Ins. Co., Sup. Ct., Los Angeles County, seeking recovery of costs related to asbestos product liability losses described above. During this coverage litigation, we entered into coverage-in-place settlement agreements with ACE, Wausau and Utica Mutual dated April 2004, September 2004, and February 2007, respectively. These agreements provide specific coverage for the Company's legacy asbestos liabilities. In December 2011, Goulds Pumps reached an agreement in principle to resolve its claims against Fireman's Fund and, in January 2012, we reached an agreement in principle with another insurer. In early January 2012, ITT and Goulds Pumps filed a putative class action against Travelers Casualty and Surety Company alleging that Travelers is unilaterally reinterpreting language contained in older Aetna policies so as to avoid paying on asbestos claims. *ITT Corporation and Goulds Pumps, Inc., v. Travelers Casualty and Surety Company (f/k/a Aetna Casualty and Surety Company,)* U.S.D.C. CT. CA No. 3:12-CU 00038. We continue to negotiate settlement agreements with other insurers, where appropriate.

On December 20, 2011, the Ad Hoc Committee of ITT Bondholders filed a Complaint in New York State court alleging that ITT breached the early redemption provisions of certain bonds issued in 2009. In 2009, ITT issued $500 in bonds maturing in 2019 at an interest rate of 6.125%. The documents governing the bonds contained certain provisions governing early redemptions. On September 20, 2011, ITT notified the holders of the debt that it intended to redeem the bonds on October 20, 2011 in accordance with the terms of the governing documents. On October 18, 2011, the redemption price was disclosed. The Plaintiffs contend that ITT used an improper discount rate in calculating the redemption price and otherwise failed to comply with required redemption procedures. If the Plaintiffs' claims are sustained, ITT could be required to pay up to $15 in additional redemption fees and interest to all holders of the bonds; however, the costs associated with this matter, if any, will be shared with Exelis and Xylem in accordance with the Distribution Agreement. See Note 4, "Discontinued Operations," for further information about the Distribution Agreement and shared liabilities. As of December 31, 2011, no amounts were accrued for this matter as the company is in the early stages of evaluating the claim. Management believes that these matters will not have a material adverse effect on our consolidated financial position, results of operations or cash flows.

NOTE 21

Guarantees, Indemnities and Warranties

Indemnities

As part of the Distribution, ITT provided certain indemnifications and cross-indemnifications among ITT, Exelis and Xylem, subject to limited exceptions with respect to certain employee claims. The indemnifications address a variety of subjects, including asserted and unasserted product liability matters (e.g., asbestos claims, product warranties) which relate to products manufactured, repaired and/or sold prior to the Distribution Date. The indemnifications are indefinite. The indemnification associated with pending and future asbestos claims does not expire. In addition, ITT, Exelis and Xylem agreed to certain cross-indemnifications with respect to other liabilities and obligations. ITT expects Exelis and Xylem to fully perform under the terms of the Distribution Agreement and therefore has not recorded a liability for matters for which we have been indemnified. In addition, we are not aware of any claims or other circumstances that would give rise to material payments to Xylem or Exelis under the indemnity provided by ITT.

Since ITT's incorporation in 1920, we have acquired and disposed of numerous entities. The related acquisition and disposition agreements contain various representation and warranty clauses and may provide indemnities for a misrepresentation or breach of the representations and warranties by either party. The indemnities address a variety of subjects; the term and monetary amounts of each such indemnity are defined in the specific agreements and may be affected by various conditions and external factors. Many of the indemnities have expired either by operation of law or as a result of the terms of the agreement. We do not have a liability recorded for these indemnifications and are not aware of any claims or other information that would give rise to material payments under such indemnities.

Guarantees

We have $192 of guarantees, letters of credit and similar arrangements outstanding at December 31, 2011 primarily pertaining to commercial or performance guarantees and insurance matters. We have not recorded any loss contingencies under these guarantees, letters of credit and similar arrangements as of December 31, 2011 as the likelihood of nonperformance by ITT is considered remote. From time to time, we may provide certain third-party guarantees that may be affected by various conditions and external factors, some of which could require that payments be made under such guarantees. We do not consider the maximum exposure or current recorded liabilities under our third-party guarantees to be material either individually or in the aggregate. We do not believe such payments would have a material adverse impact on our financial position, results of operations or cash flows on a consolidated basis.

In December 2007, we entered into a sale leaseback agreement for our corporate aircraft, with the aircraft leased to ITT under a five-year operating lease and ITT provided a residual value guarantee to the lessor for the future value of the aircraft. During the second quarter of 2011, we purchased the aircraft from the lessor for $50, the price stated in the sale leaseback agreement, and as such the sale leaseback agreement and the associated residual value guarantee were terminated. In connection with this transaction, we settled a previously recorded $22 residual value guarantee and recognized an additional charge of $3, presented within G&A expenses, as the purchase price exceeded the fair value of the aircraft at the date of termination of the sale leaseback agreement. One of the corporate aircraft was sold for a gain of $3 and the other aircraft was distributed to Exelis, and accordingly, at December 31, 2011, ITT no longer owned any corporate aircraft.

In December 2011, the Flagler County Board of Commissioners approved the termination of certain construction obligations associated with a 1984 Development Order for Development of Regional Impact ("DRI") known as Hammock Dunes, Florida. On February 1, 2012, the Flagler County Board of Commissioners released ITT from further material obligations related to the DRI and cancelled the $10 bond issued in its favor by ITT to secure the construction obligations under the DRI. As a result of the approval to terminate the construction obligation in December 2011, the Company released its $10 previously recorded contingent liability for these construction obligations.

Warranties

ITT warrants numerous products, the terms of which vary widely. In general, ITT warrants its products against defect and specific non-performance. In the certain markets, such as automotive, aerospace and rail, liability for product defects could extend beyond the selling price of the product and could be significant if the defect interrupts production or results in a recall. The table included below provides changes in the product warranty accrual for December 31, 2011 and 2010.

	2011	2010
Warranty accrual – January 1	**$27**	$ 24
Warranty expense	**8**	13
Payments	**(9)**	(10)
Warranty accrual – December 31	**$26**	$ 27

NOTE 22

Segment Information

In connection with the Distribution, we reorganized our businesses into four reportable segments: Industrial Process, Motion Technologies, ICS, and Control Technologies. The reportable segments are presented on the same basis in which management internally evaluates performance and allocates resources. All segment information has been reclassified based on our current segment structure.

Industrial Process manufactures engineered fluid process equipment serving a diversified mix of customers in global infrastructure industries such as oil & gas, mining, power generation, chemical and other process markets and is an aftermarket service provider.

Motion Technologies manufactures brake pad, shock absorber and damping technologies for the global automotive, truck, trailer and public bus and rail transportation markets.

Interconnect Solutions manufactures a wide range of highly specialized connector products that make it possible to transfer signal and power in various electronic devices that are utilized in aerospace, industrial, defense and oil & gas markets.

Control Technologies manufactures specialized equipment, including actuation, valves, switches, vibration isolation, custom-energy absorption, and regulators for the aerospace, military and industrial markets.

Corporate and Other consists of corporate office expenses including compensation, benefits, occupancy, depreciation, and other administrative costs, as well as charges related to certain matters, such as asbestos and environmental liabilities, that are managed at a corporate level and are not included in the segments in evaluating performance or allocating resources. Assets of the segments exclude general corporate assets, which principally consist of cash, company owned life insurance, deferred tax assets, insurance receivables and certain property, plant and equipment.

	REVENUE			OPERATING INCOME (LOSS)			OPERATING MARGIN		
	2011	2010	2009	**2011**	2010	2009	**2011**	2010	2009
Industrial Process	**$ 767**	$ 694	$ 719	**$ 91**	$ 79	$ 72	**11.9%**	11.4%	10.0%
Motion Technologies	**634**	548	491	**85**	85	48	**13.4%**	15.5%	9.8%
Interconnect Solutions	**418**	413	341	**38**	37	19	**9.1%**	9.0%	5.6%
Control Technologies	**318**	275	243	**55**	29	32	**17.3%**	10.5%	13.2%
Asbestos-related costs, net	**–**	–	–	**(100)**	(385)	(238)	**–**	–	–
Transformation costs	**–**	–	–	**(396)**	–	–	**–**	–	–
Eliminations / Corporate costs and Other	**(18)**	(22)	(24)	**(20)**	(29)	(54)	**–**	–	–
Total	**$2,119**	$1,908	$1,770	**$(247)**	$(184)	$(121)	**(11.7)%**	(9.6)%	(6.8)%

	TOTAL ASSETS		CAPITAL EXPENDITURES			DEPRECIATION AND AMORTIZATION		
	2011	2010	**2011**	2010	2009	**2011**	2010	2009
Industrial Process	**$ 624**	$ 529	**$ 25**	$ 19	$13	**$13**	$11	$10
Motion Technologies	**431**	383	**33**	28	37	**27**	25	25
Interconnect Solutions	**343**	309	**17**	16	11	**10**	9	10
Control Technologies	**411**	401	**6**	4	5	**13**	13	15
Corporate and Other	**1,862**	1,671	**22**	60	26	**11**	8	5
Discontinued operations	**–**	9,322	**–**	–	–	**–**	–	–
Total	**$3,671**	$12,615	**$103**	$127	$92	**$74**	$66	$65

	REVENUE[a]			TOTAL ASSETS		PLANT, PROPERTY & EQUIPMENT, NET	
Geographic Information	**2011**	2010	2009	**2011**	2010	**2011**	2010
United States	**$ 792**	$ 742	$ 710	**$2,321**	$ 2,247	**$123**	$111
Other developed markets[a][b]	**728**	663	594	**941**	721	**121**	115
Emerging markets	**599**	503	466	**409**	325	**80**	74
Discontinued operations	**–**	–	–	**–**	9,322	**–**	–
Total	**$2,119**	$1,908	$1,770	**$3,671**	$12,615	**$324**	$299

(a) Revenue to external customers is attributed to individual regions based upon the destination of product or service delivery. Germany represented 11.0%, 10.7% and 10.6% of total revenues for the years ended December 31, 2011, 2010 and 2009, respectively.

(b) Luxembourg represented 12.6% and 1.9% of total assets, excluding assets of discontinued operations, at December 31, 2011 and 2010, respectively.

The following table provides revenue by product category, net of intercompany balances.

	2011	2010	2009
Pumps and complementary products	**$ 692**	$ 633	$ 650
Pump support and maintenance services	**67**	52	57
Friction products	**524**	446	386
Shock absorber equipment	**110**	101	104
Connectors equipment	**413**	405	335
CT Aerospace products	**193**	165	148
CT Industrial products	**120**	106	90
Total	**$2,119**	$1,908	$1,770

No individual customer accounted for greater than 10% of consolidated ITT revenue during any of the three years presented.

NOTE 23

Immaterial Corrections

During the fourth quarter of 2011, management concluded the previously issued consolidated financial statements required adjustments to reflect certain immaterial corrections. Prior to the distribution of Exelis and Xylem, the Company had evaluated and concluded that the identified amounts were not material to any of its previously issued financial statements. Although management believes the amounts, individually and in the aggregate, were, and continue to be, immaterial to prior periods, management concluded that the prior period corrections to the post-Distribution financial statements are appropriate.

The Company has revised amounts previously reported in the consolidated financial statements to reflect certain adjustments, primarily related to income taxes, cumulative translation adjustments, and other adjustments, related to previously unrecorded immaterial adjustments identified during the preparation of prior years' financial statements.

As a result of these adjustments, basic and diluted earnings per share were adjusted by $0.07 and ($0.16) for 2010 and 2009, respectively, which includes $0.03 and ($0.09) in 2010 and 2009, respectively, related to discontinued operations. The impact of these adjustments are detailed in the tables below.

Income Statement as of December 31, 2010

YEAR ENDED DECEMBER 31, 2010	As Previously Reported with Reclassification For Discontinued Operations (Note 4)	Adjustments	As Adjusted and with Reclassification For Discontinued Operations
General and administrative expenses	$ 179	$(3)	$ 176
Operating loss	(187)	3	(184)
Loss from continuing operations before income tax expense	(279)	3	(276)
Loss from continuing operations	(135)	3	(132)
Income from discontinued operations	933	3	936
Net income	$ 798	$ 6	$ 804

Income Statement as of December 31, 2009

YEAR ENDED DECEMBER 31, 2009	As Previously Reported with Reclassification For Discontinued Operations (Note 4)	Adjustments	As Adjusted and with Reclassification For Discontinued Operations
General and administrative expenses	$ 195	$ 6	$ 201
Operating loss	(115)	(6)	(121)
Loss from continuing operations before income tax expense	(202)	(6)	(208)
Income tax expense	(98)	1	(97)
Loss from continuing operations	(104)	(7)	(111)
Income from discontinued operations	748	(8)	740
Net income	$ 644	$(15)	$ 629

Balance Sheet at December 31, 2010

DECEMBER 31, 2010	As Previously Reported with Reclassification For Discontinued Operations (Note 4)	Adjustments	As Adjusted and with Reclassification For Discontinued Operations
Assets			
Current assets of discontinued operations	$ 3,459	$ (2)	$ 3,457
Total current assets	4,426	(2)	4,424
Deferred income taxes (noncurrent)	339	(19)	320
Noncurrent assets of discontinued operations	5,871	(6)	5,865
Total non-current assets	8,216	(25)	8,191
Total assets	12,642	(27)	12,615
Liabilities and Shareholders' Equity			
Accrued liabilities	408	(11)	397
Current liabilities of discontinued operations	1,883	9	1,892
Total current liabilities	2,743	(2)	2,741
Other non-current liabilities	322	3	325
Noncurrent liabilities of discontinued operations	1,902	15	1,917
Total noncurrent liabilities	5,395	18	5,413
Total liabilities	8,138	16	8,154
Shareholders' Equity:			
Retained earnings	5,499	(58)	5,441
Postretirement benefit plans	(1,360)	1	(1,359)
Cumulative translation adjustments	262	14	276
Total shareholders' equity	4,504	(43)	4,461
Total liabilities and shareholders' equity	$12,642	$(27)	$12,615

Certain of the adjustments described above, or portions thereof, relate to periods prior to 2010. The cumulative effect of those adjustments to retained earnings as of January 1, 2009 and December 31, 2009 is reflected as a change of $51 and $66, respectively.

Cash Flows

The adjustments had no effect on each of the subtotals within the Consolidated Statement of Cash Flows.

SUPPLEMENTAL FINANCIAL DATA

SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

	2011 QUARTERS				2010 QUARTERS			
	FIRST	**SECOND**	**THIRD**	**FOURTH**	FIRST	SECOND	THIRD	FOURTH
Revenue	**$ 533**	**$ 553**	**$ 515**	**$ 518**	$ 501	$ 464	$ 473	$ 470
Gross profit	**168**	**176**	**155**	**156**	157	147	150	153
(Loss) income from continuing operations[(a)(b)]	**(22)**	**19**	**(29)**	**(546)**	—	11	(150)	7
Income from discontinued operations	**143**	**151**	**138**	**16**	140	226	303	267
Net income[(b)]	**121**	**170**	**109**	**(530)**	140	237	153	274
Basic earnings (loss) per share:								
Continuing operations	**$ (0.23)**	**$ 0.20**	**$ (0.32)**	**$ (5.86)**	$ —	$ 0.12	$ (1.63)	$ 0.07
Discontinued operations	**1.54**	**1.63**	**1.49**	**0.18**	1.52	2.46	3.28	2.91
Net income	**$ 1.31**	**$ 1.83**	**$ 1.17**	**$ (5.68)**	$ 1.52	$ 2.58	$ 1.65	$ 2.98
Diluted earnings (loss) per share:								
Continuing operations	**$ (0.23)**	**$ 0.20**	**$ (0.32)**	**$ (5.86)**	$ –	$ 0.12	$ (1.63)	$ 0.07
Discontinued operations	**1.54**	**1.62**	**1.49**	**0.18**	1.51	2.44	3.28	2.89
Net income	**$ 1.31**	**$ 1.82**	**$ 1.17**	**$ (5.68)**	$ 1.51	$ 2.56	$ 1.65	$ 2.96
Common stock price per share:								
High	**$128.00**	**$122.08**	**$120.26**	**$ 94.98**	$111.22	$115.98	$101.58	$106.48
Low	**$103.60**	**$108.80**	**$ 80.50**	**$ 16.67**	$ 94.82	$ 88.34	$ 84.10	$ 90.12
Close	**$120.10**	**$117.86**	**$ 84.00**	**$ 19.33**	$107.22	$ 89.84	$ 93.66	$104.22
Dividends per share	**$ 0.50**	**$ 0.50**	**$ 0.50**	**$0.091**	$ 0.50	$ 0.50	$ 0.50	$ 0.50

All per share amounts presented give effect to the 1:2 Reverse Stock Split completed on October 31, 2011. All amounts reflect the correction of certain immaterial adjustments as described in Note 23, "Immaterial Corrections."

Results from continuing operations presented in the table above, including revenue, gross profit and income from continuing operations have been restated to reflect the Distribution of Exelis and Xylem and the 2010 sale of CAS as discontinued operations.

(a) Third quarter 2011 and 2010 results include a $63 and $212 net after-tax charge to income from continuing operations, respectively. See Note 20, "Commitments and Contingencies" for further information.

(b) The quarterly periods of 2011 have been recast to reflect certain Transformation costs as discontinued operations following the completion of the Distribution. Transformation costs, net of tax are included in the quarterly results as follows:

	2011 QUARTERS			
Transformation Costs, net of tax	**FIRST**	**SECOND**	**THIRD**	**FOURTH**
Continuing operations	**$ 40**	**$ 3**	**$ 16**	**$ 198**
Discontinued operations	**23**	**43**	**77**	**30**
Total Transformation costs	**63**	**46**	**93**	**228**

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ITT Corporation
(Registrant)

By: /s/ Janice M. Klettner

Janice M. Klettner
Vice President and Chief Accounting Officer
(Principal accounting officer)

February 29, 2012

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

SIGNATURE	TITLE	DATE
/s/ DENISE L. RAMOS **Denise L. Ramos** **(Principal executive officer)**	Chief Executive Officer and President and and Director	February 29, 2012
/s/ THOMAS M. SCALERA **Thomas M. Scalera** **(Principal financial officer)**	Senior Vice President and Chief Financial Officer	February 29, 2012
/s/ JANICE M. KLETTNER **Janice M. Klettner** **(Principal accounting officer)**	Vice President and Chief Accounting Officer	February 29, 2012
/s/ ORLANDO D. ASHFORD **Orlando D. Ashford**	Director	February 29, 2012
/s/ G. PETER D'ALOIA **G. Peter D'Aloia**	Director	February 29, 2012
/s/ DONALD DEFOSSET, JR. **Donald DeFosset, Jr.**	Director	February 29, 2012
/s/ CHRISTINA A. GOLD **Christina A. Gold**	Director	February 29, 2012
/s/ PAUL J. KERN **Paul J. Kern**	Director	February 29, 2012
/s/ FRANK T. MACINNIS **Frank T. MacInnis**	Director	February 29, 2012
/s/ LINDA S. SANFORD **Linda S. Sanford**	Director	February 29, 2012
/s/ MARKOS I. TAMBAKERAS **Markos I. Tambakeras**	Director	February 29, 2012

EXHIBIT INDEX

EXHIBIT NUMBER	DESCRIPTION	LOCATION
(3.1)	ITT Corporation's Articles of Amendment of the Restated Articles of Incorporation, effective as of May 13, 2008	Incorporated by reference to Exhibit 3.1 of ITT Corporation's Form 8-K Current Report dated May 14, 2008 (CIK No. 216228, File No. 1-5672).
(3.2)	ITT Corporation's By-laws, as amended July 15, 2009	Incorporated by reference to Exhibit 3.1 of ITT Corporation's Form 8-K Current Report dated July 15, 2009 (CIK No. 216228, File No. 1-5672).
(3.3)	Amended and Restated By-laws of ITT	Incorporated by reference to Exhibit 3.1 of ITT Corporation's Form 8-K Current Report dated October 5, 2011 (CIK No. 216228, File No. 1-5672).
(3.4)	Articles of Amendment of the Articles of Incorporation of ITT Corporation	Incorporated by reference to Exhibit 3.1 of ITT Corporation's Form 8-K Current Report dated October 31, 2011 (CIK No. 216228, File No. 1-5672).
(4.1)	Indenture, dated as of September 20, 2011, between Exelis Inc., ITT Corporation, as guarantor, and Union Bank, N.A., as trustee	Incorporated by reference to Exhibit 4.1 of ITT Corporation's Form 8-K Current Report dated September 21, 2011 (CIK No. 216228, File No. 1-5672).
(4.2)	Indenture, dated as of September 20, 2011, between Xylem Inc., ITT Corporation, as guarantor, and Union Bank, N.A., as trustee	Incorporated by reference to Exhibit 4.2 of ITT Corporation's Form 8-K Current Report dated September 21, 2011 (CIK No. 216228, File No. 1-5672).
(4.3)	Form of Exelis Inc. 4.250% Senior Notes due 2016	Incorporated by reference to Exhibit 4.3 of ITT Corporation's Form 8-K Current Report dated September 21, 2011 (CIK No. 216228, File No. 1-5672).
(4.4)	Form of Exelis Inc. 4.250% Senior Notes due 2021	Incorporated by reference to Exhibit 4.4 of ITT Corporation's Form 8-K Current Report dated September 21, 2011 (CIK No. 216228, File No. 1-5672).
(4.5)	Form of Exelis Inc. 4.250% Senior Notes due 2016	Incorporated by reference to Exhibit 4.5 of ITT Corporation's Form 8-K Current Report dated September 21, 2011 (CIK No. 216228, File No. 1-5672).
(4.6)	Form of Exelis Inc. 4.250% Senior Notes due 2021	Incorporated by reference to Exhibit 4.6 of ITT Corporation's Form 8-K Current Report dated September 21, 2011 (CIK No. 216228, File No. 1-5672).
(4.7)	Registration Rights Agreement, dated as of September 20, 2011, between Exelis Inc., ITT Corporation and Barclays Capital Inc., Citigroup Global Markets Inc. and J.P. Morgan Securities LLC, as representatives of the Initial Purchases	Incorporated by reference to Exhibit 4.7 of ITT Corporation's Form 8-K Current Report dated September 21, 2011 (CIK No. 216228, File No. 1-5672).
(4.8)	Registration Rights Agreement, dated as of September 20, 2011, between Xylem Inc., ITT Corporation and J.P. Morgan Securities LLC, RBS Securities Inc. and Wells Fargo Securities, LLC., as representatives of the Initial Purchasers.	Incorporated by reference to Exhibit 4.8 of ITT Corporation's Form 8-K Current Report dated September 21, 2011 (CIK No. 216228, File No. 1-5672).
(10.01)	Distribution Agreement, dated as of October 25, 2011, among ITT Corporation, Xylem Inc. and Exelis Inc.	Incorporated by reference to Exhibit 10.1 of ITT Corporation's Form 10-Q for the quarter ended September 30, 2011 (CIK No. 216228, File No. 1-5672).
(10.02)	Benefits and Compensation Matters Agreement, dated as of October 25, 2011, among ITT Corporation, Xylem Inc. and Exelis Inc.	Incorporated by reference to Exhibit 10.2 of ITT Corporation's Form 10-Q for the quarter ended September 30, 2011 (CIK No. 216228, File No. 1-5672).
(10.03)	Tax Matters Agreement, dated as of October 25, 2011, among ITT Corporation, Xylem Inc. and Exelis Inc.	Incorporated by reference to Exhibit 10.3 of ITT Corporation's Form 10-Q for the quarter ended September 30, 2011 (CIK No. 216228, File No. 1-5672).
(10.04)	Master Transition Services Agreement, dated as of October 25, 2011, among ITT Corporation, Xylem Inc. and Exelis Inc.	Incorporated by reference to Exhibit 10.4 of ITT Corporation's Form 10-Q for the quarter ended September 30, 2011 (CIK No. 216228, File No. 1-5672).
(10.05)	ITT Transitional Trademark License Agreement – Exelis, dated as of October 25, 2011, between ITT Manufacturing Enterprises LLC and Exelis Inc.	Incorporated by reference to Exhibit 10.5 of ITT Corporation's Form 10-Q for the quarter ended September 30, 2011 (CIK No. 216228, File No. 1-5672).
(10.06)	Master Lease Agreement and Master Sublease Agreement, dated as of October 25, 2011 and September 30, 2011, respectively	Incorporated by reference to Exhibit 10.6 of ITT Corporation's Form 10-Q for the quarter ended September 30, 2011 (CIK No. 216228, File No. 1-5672).

EXHIBIT NUMBER	DESCRIPTION	LOCATION
(10.07)	Four-Year Competitive Advance and Revolving Credit Facility Agreement, dated as of October 25, 2011 among ITT Corporation and Other Parties Signatory Thereto	Incorporated by reference to Exhibit 10.7 of ITT Corporation's Form 10-Q for the quarter ended September 30, 2011 (CIK No. 216228, File No. 1-5672).
(10.08)*	Steve Loranger Resignation Agreement	Incorporated by reference to Exhibit 10.1 of ITT Corporation's Form 8-K dated October 14, 2011 (CIK No. 216228, File No. 1-5672).
(10.09)*	2011 Omnibus Incentive Plan	Incorporated by reference to Exhibit 4.3 of ITT Corporation's Registration Statement on Form S-8 as filed on October 28, 2011 (CIK No. 216228, File No. 1-5672).
(10.10)*	ITT Corporation Retirement Savings Plan for Salaried Employees (effective October 31, 2011)	Incorporated by reference to Exhibit 4.4 of ITT Corporation's Registration Statement on Form S-8 as filed on October 28, 2011 (CIK No. 216228, File No. 1-5672).
(10.11)*	ITT Deferred Compensation Plan	Incorporated by reference to Exhibit 4.5 of ITT Corporation's Registration Statement on Form S-8 as filed on October 28, 2011 (CIK No. 216228, File No. 1-5672).
(10.12)*	ITT Corporation Form of Non-Qualified Stock Option Agreement (Band A Employees)	Incorporated by reference to Exhibit 10.01 of ITT Corporation's Form 10-Q for the quarter ended March 31, 2011 (CIK No. 216228, File No. 1-5672).
(10.13)*	ITT Corporation Form of Non-Qualified Stock Option Agreement (Non-Band A Employees)	Incorporated by reference to Exhibit 10.02 of ITT Corporation's Form 10-Q for the quarter ended March 31, 2011 (CIK No. 216228, File No. 1-5672).
(10.14)*	ITT Corporation Form of Restricted Stock Award Agreement	Incorporated by reference to Exhibit 10.03 of ITT Corporation's Form 10-Q for the quarter ended March 31, 2011 (CIK No. 216228, File No. 1-5672).
(10.15)*	ITT Corporation Form TSR Award Agreement	Incorporated by reference to Exhibit 10.04 of ITT Corporation's Form 10-Q for the quarter ended March 31, 2011 (CIK No. 216228, File No. 1-5672).
(10.16)*	Employment Agreement dated as of June 28, 2004 between ITT Industries, Inc. and Steven R. Loranger (amended as of December 18, 2008)	Incorporated by reference to Exhibit 99.1 of ITT Corporation's Form 8-K dated December 19, 2008. (CIK No. 216228, File No. 1-5672).
(10.17)*	Form of Non-Qualified Stock Option Award Agreement for Band A Employees	Incorporated by reference to Exhibit 10.3 of ITT Industries' Form 10-K for the year ended December 31, 2004 (CIK No. 216228, File No. 1-5672).
(10.18)*	Form of Non-Qualified Stock Option Award Agreement for Band B Employees	Incorporated by reference to Exhibit 10.4 of ITT Industries' Form 10-K for the year ended December 31, 2004 (CIK No. 216228, File No. 1-5672).
(10.19)*	ITT 2003 Equity Incentive Plan, amended and restated as of February 15, 2008 and approved by shareholders on May 13, 2008 (previously amended and restated as of July 13, 2004 and subsequently amended as of December 18, 2006) and previously known as ITT Industries, Inc. 2003 Equity Incentive Plan	Incorporated by reference to Exhibit 10.5 of ITT Corporation's Form 10-Q for the quarter ended June 30, 2008 (CIK No. 216228, File No. 1-5672).
(10.20)*	ITT Corporation 1997 Long-Term Incentive Plan, amended and restated as of February 15, 2008 and approved by shareholders on May 13, 2008 (previously amended and restated as of July 13, 2004) and formerly known as ITT Industries, Inc. 1997 Long-Term Incentive Plan	Incorporated by reference to Exhibit 10.6 of ITT Corporation's Form 10-Q for the quarter ended June 30, 2008 (CIK No. 216228, File No. 1-5672).
(10.21)*	ITT Corporation Annual Incentive Plan for Executive Officers, amended and restated as of February 15, 2008 and approved by shareholders on May 13, 2008 previously known as 1997 Annual Incentive Plan for Executive Officers (amended and restated as of July 13, 2004) and also previously known as ITT Industries, Inc. 1997 Annual Incentive Plan for Executive Officers (amended and restated as of July 13, 2004)	Incorporated by reference to Exhibit 10.7 of ITT Corporation's Form 10-Q for the quarter ended June 30, 2008 (CIK No. 216228, File No. 1-5672).

EXHIBIT NUMBER	DESCRIPTION	LOCATION
(10.22)*	1994 ITT Incentive Stock Plan (amended and restated as of July 13, 2004 and subsequently amended as of December 19, 2006) formerly known as 1994 ITT Industries Incentive Stock Plan (amended and restated as of July 13, 2004)	Incorporated by reference to Exhibit 10.8 of ITT Corporation's Form 10-K for the year ended December 31, 2006 (CIK No. 216228, File No. 1-5672).
(10.23)*	ITT Corporation Special Senior Executive Severance Pay Plan amended and restated as of December 31, 2008 (previously amended and restated as of July 13, 2004) and formerly known as ITT Industries Special Senior Executive Severance Pay Plan	Incorporated by reference to Exhibit 10.9 of ITT Corporation's Form 10-K for the year ended December 31, 2008 (CIK No. 216228, File No. 1-5672).
(10.24)*	ITT 1996 Restricted Stock Plan for Non-Employee Directors (amended and restated as of July 13, 2004 and subsequently amended as of December 19, 2006) formerly known as ITT Industries 1996 Restricted Stock Plan for Non-Employee Directors (amended and restated as of July 13, 2004)	Incorporated by reference to Exhibit 10.10 of ITT Corporation's Form 10-K for the year ended December 31, 2006 (CIK No. 216228, File No. 1-5672).
(10.25)*	ITT Corporation Enhanced Severance Pay Plan (amended and restated as of July 13, 2004) and formerly known as ITT Industries Enhanced Severance Pay Plan (amended and restated as of July 13, 2004). Amended and restated as of December 31, 2008	Incorporated by reference to Exhibit 10.11 of ITT Corporation's Form 10-K for the year ended December 31, 2008 (CIK No. 216228, File No. 1-5672).
(10.26)*	ITT Deferred Compensation Plan (Effective as of January 1, 1995 including amendments through July 13, 2004) formerly known as ITT Industries Deferred Compensation Plan (Effective as of January 1, 1995 including amendments through July 13, 2004). Amended and restated as of December 31, 2008	Incorporated by reference to Exhibit 10.12 of ITT Corporation's Form 10-K for the year ended December 31, 2008 (CIK No. 216228, File No. 1-5672).
(10.27)*	ITT 1997 Annual Incentive Plan (amended and restated as of July 13, 2004) formerly known as ITT Industries 1997 Annual Incentive Plan (amended and restated as of July 13, 2004)	Incorporated by reference to Exhibit 10.13 of ITT Industries' Form 10-Q for the quarter ended September 30, 2004 (CIK No. 216228, File No. 1-5672).
(10.28)*	ITT Excess Pension Plan IA formerly known as ITT Industries Excess Pension Plan IA. Originally effective as of July 1, 1975. Amended and restated as of December 31, 2008	Incorporated by reference to Exhibit 10.14 of ITT Corporation's Form 10-K for the year ended December 31, 2008 (CIK No. 216228, File No. 1-5672).
(10.29)*	ITT Excess Pension Plan IB formerly known as ITT Industries Excess Pension Plan IB. Originally effective as of January 1, 1996. Amended and restated as of December 31, 2008	Incorporated by reference to Exhibit 10.15 of ITT Corporation's Form 10-K for the year ended December 31, 2008 (CIK No. 216228, File No. 1-5672).
(10.30)*	ITT Excess Pension Plan IIA formally known as ITT Excess Pension Plan II, and ITT Industries Excess Pension Plan II (as amended and restated as of July 13, 2004) originally effective as of January 1, 1988. Amended and restated as of December 31, 2008	Incorporated by reference to Exhibit 10.16 of ITT Corporation's Form 10-K for the year ended December 31, 2008 (CIK No. 216228, File No. 1-5672).
(10.31)*	ITT Excess Savings Plan (as amended and restated as of July 13, 2004) formerly known as ITT Industries Excess Savings Plan (as amended and restated as of July 13, 2004). Amended and restated effective December 31, 2008	Incorporated by reference to Exhibit 10.17 of ITT Corporation's Form 10-K for the year ended December 31, 2008 (CIK No. 216228, File No. 1-5672).
(10.32)*	ITT Industries Excess Benefit Trust	Incorporated by reference to Exhibit 10.18 of ITT Industries' Form 10-Q for the quarter ended September 30, 2004 (CIK No. 216228, File No. 1-5672).
(10.33)	Form of indemnification agreement with directors	Incorporated by reference to Exhibit 10(h) to ITT Industries' Form 10-K for the fiscal year ended December 31, 1996 (CIK No. 216228, File No. 1-5672).
(10.34)*	Form of Restricted Stock Award for Non-Employee Directors	Incorporated by reference to Exhibit 10.28 of ITT Industries' Form 10-Q for the quarter ended September 30, 2005 (CIK No. 216228, File No. 1-5672).
(10.35)*	Form of Restricted Stock Award for Employees	Incorporated by reference to Exhibit 10.29 of ITT Industries' Form 10-Q for the quarter ended September 30, 2005 (CIK No. 216228, File No. 1-5672).
(10.36)	Amended and Restated 364-day Revolving Credit Agreement	Incorporated by reference to Exhibits 10.1 and 10.2 to ITT Industries' Form 8-K dated March 28, 2005 (CIK No. 216228, File No. 1-5672).

EXHIBIT NUMBER	DESCRIPTION	LOCATION
(10.37)*	ITT Corporation Senior Executive Severance Pay Plan. (previously known as the ITT Industries, Inc. Senior Executive Severance Pay Plan, dated December 20, 1995, amended and restated as of December 31, 2008)	Incorporated by reference to Exhibit 10.32 of ITT Corporation's Form 10-K for the year ended December 31, 2008 (CIK No. 216228, File No. 1-5672).
(10.38)	Non-Employee Director Compensation Agreement	Incorporated by reference to Exhibit 10.1 to ITT Industries' Form 8-K Current Report dated December 1, 2005 (CIK No. 216228, File No. 1-5672).
(10.39)*	Form of 2006 Non-Qualified Stock Option Award Agreement for Band A Employees	Incorporated by reference to Exhibit 10.34 of ITT Industries' Form 10-Q for the quarter ended March 31, 2006 (CIK No. 216228, File No. 1-5672).
(10.40)*	Form of 2006 Non-Qualified Stock Option Award Agreement for Band B Employees	Incorporated by reference to Exhibit 10.35 of ITT Industries' Form 10-Q for the quarter ended March 31, 2006 (CIK No. 216228, File No. 1-5672).
(10.41)*	Form of 2006 Restricted Stock Award Agreement for Employees	Incorporated by reference to Exhibit 10.36 of ITT Industries' Form 10-Q for the quarter ended March 31, 2006 (CIK No. 216228, File No. 1-5672).
(10.42)	Form of 2006 Non-Qualified Stock Option Award Agreement for Non-Employee Directors	Incorporated by reference to Exhibit 10.37 of ITT Industries' Form 10-Q for the quarter ended March 31, 2006 (CIK No. 216228, File No. 1-5672).
(10.43)	2002 ITT Stock Option Plan for Non-Employee Directors formerly known as the 2002 ITT Industries, Inc. Stock Option Plan for Non-Employee Directors (as amended on December 19, 2006)	Incorporated by reference to Exhibit 10.38 of ITT Corporation's Form 10-K for the year ended December 31, 2006 (CIK No. 216228, File No. 1-5672).
(10.44)*	Employment Agreement dated as of May 21, 2007 and effective as of July 1, 2007 between ITT Corporation and Denise L. Ramos.	Incorporated by reference to Exhibit 99.1 to ITT Corporation Form 8-K dated July 2, 2007 (CIK No. 216228, File No. 1-5672).
(10.45)	Agreement and Plan of Merger	Incorporated by reference to Exhibit 2.1 and 2.2 to ITT Corporation's Form 8-K dated September 18, 2007 (CIK No. 216228, File No. 1-5672).
(10.46)	Accession Agreement to Five-Year Competitive Advance and Revolving Credit Facility	Incorporated by reference to Exhibit 2.03 to ITT Corporation's Form 8-K dated November 8, 2007 (CIK No. 216228, File No. 1-5672).
(10.47)	Summary of material terms of amendments to ITT Excess Pension Plan 1A and the ITT Excess Pension Plan 1B, the ITT Excess Pension Plan II, the ITT Excess Savings Plan, the ITT Deferred Compensation Plan and the severance plans and policies of the Company and its subsidiaries and other affiliates	Incorporated by reference to Exhibit 5.02 to ITT Corporation's Form 8-K dated December 19, 2007 (CIK No. 216228, File No. 1-5672).
(10.48)	Senior Notes Offering	Incorporated by reference to Exhibit 9.01(d) to ITT Corporations Form 8-K dated April 28, 2009 (CIK No. 216228, File No. 1-5672).
(10.49)	Issuance of Commercial Paper	Incorporated by Reference to Exhibit 2.03 to ITT Corporation's Form 8-K dated December 20, 2007 (CIK No. 216228, File No. 1-5672).
(10.50)	ITT Corporation 2003 Equity Incentive Plan Restricted Stock Unit Award Agreement – Non-Employee Director	Incorporated by reference to Exhibit 10.46 of ITT Corporation's Form 10-Q for the quarter ended June 30, 2008 (CIK No. 216228, File No. 1-5672).
(10.51)	ITT Corporation 2003 Equity Incentive Plan Director Restricted Stock Unit Award Deferral Election Form	Incorporated by reference to Exhibit 10.47 of ITT Corporation's Form 10-Q for the quarter ended June 30, 2008 (CIK No. 216228, File No. 1-5672).
(10.52)	ITT Corporation Deferred Compensation Plan for Non-Employee Directors	Incorporated by reference to Exhibit 10.48 of ITT Corporation's Form 10-Q for the quarter ended September 30, 2008 (CIK No. 216228, File No. 1-5672).
(10.53)	ITT Corporation Deferred Compensation Plan for Non-Employee Directors Deferral Election Form for those Directors without a Specified Distribution Date for Non-Grandfathered Deferrals	Incorporated by reference to Exhibit 10.49 of ITT Corporation's Form 10-Q for the quarter ended September 30, 2008 (CIK No. 216228, File No. 1-5672).

EXHIBIT NUMBER	DESCRIPTION	LOCATION
(10.54)	ITT Corporation Deferred Compensation Plan for Non-Employee Directors Deferral Election Form for those Directors with a Specified Distribution Date for Non-Grandfathered Deferrals	Incorporated by reference to Exhibit 10.50 of ITT Corporation's Form 10-Q for the quarter ended September 30, 2008 (CIK No. 216228, File No. 1-5672).
(10.55)	ITT Corporation Deferred Compensation Plan for Non-Employee Directors Subsequent Election Form	Incorporated by reference to Exhibit 10.51 of ITT Corporation's Form 10-Q for the quarter ended September 30, 2008 (CIK No. 216228, File No. 1-5672).
(10.56)	ITT 2003 Equity Incentive Plan Director Restricted Stock Unit Award Deferral Election Form	Incorporated by reference to Exhibit 10.52 of ITT Corporation's Form 10-Q for the quarter ended September 30, 2008 (CIK No. 216228, File No. 1-5672).
(10.57)	ITT Corporation Non-Employee Director Deferred Restricted Stock Unit Award Subsequent Election Form	Incorporated by reference to Exhibit 10.53 of ITT Corporation's Form 10-K for the year ended December 31, 2008 (CIK No. 216228, File No. 1-5672).
(10.58)	ITT Director Consent Letter – Required Modifications to Prior Annual Retainer Deferrals.	Incorporated by reference to Exhibit 10.54 of ITT Corporation's Form 10-K for the year ended December 31, 2008 (CIK No. 216228, File No. 1-5672).
(10.59)*	ITT Excess Pension Plan IIB. Effective as of January 1, 1988. As Amended and Restated as of December 31, 2008	Incorporated by reference to Exhibit 10.55 of ITT Corporation's Form 10-K for the year ended December 31, 2008 (CIK No. 216228, File No. 1-5672).
(10.60)*	ITT Corporation Form of Non-Qualified Stock Option Agreement (Band A)	Incorporated by reference to Exhibit 10.56 of ITT Corporation's Form 10-Q for the quarter ended March 31, 2009 (CIK No. 216228, File No. 1-5672).
(10.61)*	ITT Corporation Form of Non-Qualified Stock Option Agreement (Non Band A)	Incorporated by reference to Exhibit 10.57 of ITT Corporation's Form 10-Q for the quarter ended March 31, 2009 (CIK No. 216228, File No. 1-5672).
(10.62)*	Employment Agreement dated as of October 4, 2011 and effective as of October 31, 2011 between ITT Corporation and Denise L. Ramos.	Incorporated by reference to Exhibit 10.1 of ITT Corporation's Form 8-K/A dated October 17, 2011 (CIK No. 216228, File No. 1-5672).
(11)	Statement re computation of per share earnings	Not required to be filed.
(12)	Statement re computation of ratios	Filed herewith.
(18)	Letter re change in accounting principles	Incorporated by reference to Exhibit 18 of ITT Corporation's Form 10-Q for the quarter ended September 30, 2006 (CIK No. 216228, File No. 1-5672).
(21)	Subsidiaries of the Registrant	Filed herewith.
(22)	Published report regarding matters submitted to vote of Security holders	Not required to be filed.
(23.1)	Consent of Deloitte & Touche LLP	Filed herewith.
(24)	Power of attorney	None.
(31.1)	Certification pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	Filed herewith.
(31.2)	Certification pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	Filed herewith.
(32.1)	Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	This Exhibit is intended to be furnished in accordance with Regulation S-K Item 601(b) (32) (ii) and shall not be deemed to be filed for purposes of Section 18 of the Securities Exchange Act of 1934 or incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except as shall be expressly set forth by specific reference.

EXHIBIT NUMBER	DESCRIPTION	LOCATION
(32.2)	Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	This Exhibit is intended to be furnished in accordance with Regulation S-K Item 601(b) (32) (ii) and shall not be deemed to be filed for purposes of Section 18 of the Securities Exchange Act of 1934 or incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except as shall be expressly set forth by specific reference.
(99.1)	Deferred Prosecution Agreement filed March 28, 2007 between ITT Corporation and the United States Attorney's Office for the Western District of Virginia	Incorporated by reference to Exhibit 99.4 of ITT Corporation's Form 8-K dated March 30, 2007 (CIK No. 216228, File No. 1-5672).
(99.2)	Administrative Compliance Agreement filed October 11, 2007 between ITT Corporation and The United States Agency (Suspensions' Department Affiliate for the U.S. Army) on behalf of the U.S. Government	Incorporated by reference to Exhibit 99.1 of ITT Corporation's Form 8-K dated October 12, 2007 (CIK No. 216228, File No. 1-5672).
(101)	The following materials from ITT Corporation's Annual Report on Form 10-K for the year ended December 31, 2011, formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Income Statements, (ii) Consolidated Statements of Comprehensive Income (Loss), (iii) Consolidated Balance Sheets, (iv) Consolidated Statements of Cash Flows, (v) Consolidated Statements of Changes in Shareholders' Equity and (vi) Notes to Consolidated Financial Statements	Submitted electronically with this report.

* Management compensatory plan

EXHIBIT 12

CALCULATION OF RATIO OF EARNINGS TO TOTAL FIXED CHARGES

(In millions, except ratio)

	2011	2010	2009	2008	2007
Earnings:					
(Loss) income from continuing operations before income tax expense	**$(318)**	$(276)	$(208)	$ 70	$ 116
Add:					
Fixed Charges	**78**	99	100	144	98
Total (loss) earnings available for fixed charges	**(240)**	(177)	(108)	214	214
Fixed Charges:					
Interest expense and other financial charges	**76**	97	97	141	95
Reasonable approximation of portion of rent under long-term operating leases representative of an interest factor	**2**	2	3	3	3
Total fixed charges	**78**	99	100	144	98
(Deficiency) ratio of earnings to total fixed charges	**(240)**	(177)	(108)	1.5x	2.2x

[a] We computed the ratio of earnings to fixed charges by dividing earnings (earnings from continuing operations before cumulative effect of change in accounting principle and taxes, adjusted for fixed charges from continuing operations, minority interest in the income of subsidiaries with fixed charges and undistributed earnings or loss of equity method investees) by fixed charges from continuing operations for the periods indicated. Fixed charges from continuing operations include (i) interest expense and amortization of debt discount or premium on all indebtedness, and (ii) a reasonable approximation of interest factor deemed to be included in rental expense.

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EXHIBIT 21

SUBSIDIARIES OF THE REGISTRANT

Set forth below are the names of subsidiaries, divisions and related organizations of ITT Corporation, the respective jurisdiction in which each was organized (in the case of subsidiaries), and the name under which each does business (if other than the name of the entity itself).

Name	Jurisdiction In Which Organized	Name Under Which Performing Business
Admiral Corporation	Florida	Admiral
Aimco Industries, Inc.	New York	
Bolton Insurance Company	New York	
Carbon Fuel Co.	West Virginia	
Carbon Industries, Inc.	West Virginia	Carbon
Cleveland Motion Controls, Inc.	Ohio	
Computer & Equipment Leasing Corporation	Wisconsin	
Corprop A&F, Inc.	Delaware	
Goulds Pumps (IPG), Inc.	Delaware	Goulds Pumps
Goulds Pumps (NY), Inc.	New York	Goulds Pumps
Goulds Pumps (P-A), Inc.	Delaware	Goulds Pumps
Goulds Pumps Administration, Inc.	New York	
Goulds Pumps, Inc.	Delaware	Goulds Pumps
GP Holding Company, Inc.	Delaware	Goulds Pumps
Great American Gumball Corporation	California	
Interconnect Solutions Division	N/A	
International Motion Control (China) Ltd	Delaware	
International Motion Control, Inc.	Delaware	
International Standard Electric Corporation	Delaware	
ITT Aerospace Controls LLC	Delaware	
ITT AES Enterprises, Inc.	Delaware	
ITT Ameritool Divesting, Inc.	New York	
ITT Automotive Asia-Pacific, Inc.	Delaware	
ITT Automotive Enterprises, Inc.	Delaware	
ITT Baylock Manufacturing Co.	Michigan	
ITT C 'Treat LLC	Delaware	C'Treat Offshore
ITT Cannon International, Inc.	Delaware	
ITT Cannon LLC	Delaware	
ITT Cannon Mexico, Inc.	Delaware	
ITT Community Development Corporation	Delaware	
ITT Conoflow Division	N/A	
ITT Delaware Investments LLC	Delaware	
ITT Engineered Valves, LLC	Delaware	
ITT Enidine, Inc.	Delaware	
ITT Fluid Technology Corporation	Delaware	

Name	Jurisdiction In Which Organized	Name Under Which Performing Business
ITT Fluid Technology International, Inc.	Delaware	
ITT Higbie Manufacturing Company	Delaware	
ITT Industries Asset Management, Inc.	Delaware	
ITT Industries Friction, Inc.	Delaware	
ITT Industries Holdings, Inc.	Delaware	
ITT International Holdings, Inc.	Delaware	
ITT Land Corporation	Florida	
ITT Manufacturing Enterprises, LLC	Delaware	
ITT Motion Technologies America, LLC	Delaware	
ITT Remediation Management, Inc.	Delaware	
ITT Resource Development LLC	Delaware	
ITT Thompson Industries, Inc.	Delaware	
ITT Veam LLC	Delaware	
ITT Water and Wastewater USA, Inc.	Delaware	
ITT Water Technology (TX) LLC	Delaware	
Jarret, Inc.	Delaware	
JINOO Holdings, Inc.	Delaware	
Kaliburn, Inc.	South Carolina	
Kentucky Carbon Corp.	West Virginia	
Koni NA LLC	Delaware	Koni
Leland Properties	Delaware	
Paul N. Howard Corporation	North Carolina	
PureFlo LLC	Delaware	
Rio Bayamon Corporation	Delaware	
Rochester Form Machine, Inc.	New York	
Rule Industries Inc.	Massachusetts	
Sunsport Recreation Corporation	Florida	
TDS Corporate Services LLC	Delaware	
Standard Electric (ALGERIA)	Algeria	
Corporation Financiera Stnd. Elec. (ARGENTINA)	Argentina	
Bombas Goulds Argentina S.A. (ARGENTINA)	Argentina	Goulds Pumps
ITT Blakers Pty Ltd (AUSTRALIA)	Australia	
ITT Australia Holdings Pty Ltd (AUSTRALIA)	Australia	
Australian Branch of ITT Fluid Technologies International, Inc.	Australia	
ITT Blakers Pump Engineers Unit Trust	Australia	
ITT Industries Fluid Handling Do Brazil Ltda (BRAZIL)	Brazil	
Brasil Ltda (BRAZIL)	Brazil	
ITT Bombas Goulds do Brasil LTDA (BRAZIL)	Brazil	

Name	Jurisdiction In Which Organized	Name Under Which Performing Business
1448170 Ontario Ltd (CANADA)	Canada	Goulds Pumps
Goulds Pumps Canada, Inc. (CANADA)	Canada	
ITT Fluid Technology S.A. (CHILE)	Chile	
ITT (China) Investment Co. LTD (CHINA)	China	
ITT Canon Electronics (Shenzhen) Co., Ltd (CHINA)	China	
ITT High Precision Manufactured Products (WUXI) Co Ltd (CHINA)	China	
Nanjing Branch of ITT High Precision Manufactured Products (WUXI) Co Ltd (CHINA)	China	
Shanghai Branch of ITT (CHINA) Investment Co. LTD (CHINA)	China	
Shanghai Goulds Pumps Co. Ltd (CHINA)	China	
ITT Goulds Pumps Colombia SAS (COLOMBIA)	Colombia	
ITT Holdings Czech Republic (CZECH REPUBLIC)	Czech Republic	
ITT Industries France SAS (FRANCE)	France	
Koni France (FRANCE)	France	Koni
BVE Controls GmbH (GERMANY)	Germany	
DITTHA GmbH (GERMANY)	Germany	
ITT Cannon Gmbh (GERMANY)	Germany	
ITT Control Technologies GmbH (GERMANY)	Germany	
ITT Germany Holdings GmbH (GERMANY)	Germany	
ITT Industries German Asset Management GmbH (GERMANY)	Germany	
ITT Industries Vermogensverwaltungs GmbH (GERMANY)	Germany	
ITT Cannon Gmbh (GERMANY) New Denmark Branch Office	Germany-Denmark	
ITT Cannon (Hong Kong) Limited (HONG KONG)	Hong Kong	
ITT Corporation India Pvt Ltd (INDIA)	India	
PT (Indonesia) ITT Fluid Technology (INDONESIA)	Indonesia	
ITT Cannon VEAM Italia Srl (ITALY)	Italy	
ITT Italia Srl (ITALY)	Italy	
ITT Italy Holdings SRL (ITALY)	Italy	
Enidine Kabashiki Gaisha (JAPAN)	Japan	
ITT Cannon Ltd. (JAPAN)	Japan	

Name	Jurisdiction In Which Organized	Name Under Which Performing Business
Goulds Pumps Co Ltd (KOREA)	Korea	Goulds Pumps
ITT Cannon Korea Ltd (KOREA)	Korea	
ITT Industries Luxembourg SARL	Luxembourg	
ITT International Luxembourg SARL	Luxembourg	
Bombas Goulds de Mexico (MEXICO)	Mexico	Goulds Pumps
Industrias Thompson de Mexico S.A. de C.V. (MEXICO)	Mexico	
ITT Cannon de Mexico S.A. de C.V. (MEXICO)	Mexico	
Koni BV (NETHERLANDS)	Netherlands	Koni
ITT New Zealand Ltd. (New Zealand)	New Zealand	
Industrias de Telecommunicaciones del Peru (PERU)	Peru	
Russian Branch of ITT Fluid Technology International, Inc.	Russia	
ITT Saudi Company (SAUDI ARABIA)	Saudi Arabia	
ITT Fluid Technology Asia Pte Ltd (SINGAPORE)	Singapore	
South African Branch of ITT Fluid Technology International, Inc.	South Africa	
ITT Fluid Technology International (Thailand) Ltd (THAILAND)	Thailand	
Standard Tecknik Services (TURKEY)	Turkey	
ITT Consumer Products (UK) Ltd (UK)	United Kingdom	
ITT Corporation Ltd (UK)	United Kingdom	
ITT Datacommunications Ltd (UK)	United Kingdom	
ITT Ltd (UK)	United Kingdom	
ITT World Directories (UK) Ltd	United Kingdom	
Cannon Electric (GB) Ltd (UK)	United Kingdom	
Cleveleand Motion Controls Ltd (UK)	United Kingdom	
ITT Industries Holdings Limited (UK)	United Kingdom	
ITT Industries Limited (UK)	United Kingdom	
ITT Pure-Flo (UK) Limited (UK)	United Kingdom	
Bombas Goulds De Venezuela CA (VENEZUELA)	Venezuela	Goulds Pumps
Distribuidora Arbos, CA (VENEZUELA)	Venezuela	
Equipos Hidraulicos S.A. (VENEZUELA)	Venezuela	

Note: The names of certain subsidiaries have been omitted since, considered in the aggregate, they would not constitute a "significant subsidiary" as of the end of the year covered by this report.

EXHIBIT 31.1

**CERTIFICATION OF DENISE L. RAMOS PURSUANT TO SEC. 302
OF THE SARBANES-OXLEY ACT OF 2002
CERTIFICATION**

I, Denise L. Ramos, certify that:

1. I have reviewed this Annual Report on Form 10-K for the year ended December 31, 2011 of ITT Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's fourth fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ DENISE L. RAMOS

Denise L. Ramos
Chief Executive Officer
and President

Date: February 29, 2012

EXHIBIT 31.2

**CERTIFICATION OF THOMAS M. SCALERA PURSUANT TO SEC. 302
OF THE SARBANES-OXLEY ACT OF 2002
CERTIFICATION**

I, Thomas M. Scalera, certify that:

1. I have reviewed this Annual Report on Form 10-K for the year ended December 31, 2011 of ITT Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's fourth fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ THOMAS M. SCALERA

Thomas M. Scalera
Senior Vice President and
Chief Financial Officer

Date: February 29, 2012

EXHIBIT 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of ITT Corporation (the Company) on Form 10-K for the period ended December 31, 2011 as filed with the Securities and Exchange Commission on the date hereof (the Report), I, Denise L. Ramos, (the Report), Chief Executive Officer and President of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ DENISE L. RAMOS

Denise L. Ramos
Chief Executive Officer
and President

February 29, 2012

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

EXHIBIT 32.2

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of ITT Corporation (the Company) on Form 10-K for the period ended December 31, 2011 as filed with the Securities and Exchange Commission on the date hereof (the Report), I, Thomas M. Scalera, Senior Vice President and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ THOMAS M. SCALERA

Thomas M. Scalera
Senior Vice President and
Chief Financial Officer

February 29, 2012

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

Shareowner Information

Left to right: G. Peter D'Aloia, Christina A. Gold, Donald DeFosset, Jr., General Paul J. Kern (Ret.), Markos I. Tambakeras, Frank T. MacInnis, Denise L. Ramos, Orlando D. Ashford, and Linda S. Sanford (not pictured: Donald J. Stebbins)

BOARD OF DIRECTORS

Orlando D. Ashford
Senior Vice President, Chief Human Resources and Communications Officer, Marsh & McLennan Cos.

G. Peter D'Aloia
Former Senior Vice President and Chief Financial Officer, American Standard Companies, Inc.

Donald DeFosset, Jr.
Former Chairman, James Hardie Industries N.V.

Christina A. Gold
Former President, Chief Executive Officer and Director, The Western Union Company, Inc.

General Paul J. Kern, U.S. Army (Ret.)
Senior Counselor, The Cohen Group

Frank T. MacInnis
Chairman of the ITT Board of Directors and Chairman and Former Chief Executive Officer, EMCOR Group, Inc.

Denise L. Ramos
Chief Executive Officer and President

Linda S. Sanford
Senior Vice President, Enterprise Transformation, IBM Corp.

Donald J. Stebbins
Chairman, Chief Executive Officer and President, Visteon Corp.

Markos I. Tambakeras
Former Chairman, President and Chief Executive Officer, Kennametal, Inc.

INDEPENDENT AUDITORS

Deloitte & Touche LLP
333 Ludlow Street
Stamford, CT 06902

ANNUAL MEETING OF SHAREOWNERS

The annual meeting will be held at 10:30 a.m. EDT on Tuesday, May 8, 2012 at: Doral Arrowwood Hotel Conference Center, 975 Anderson Hill Road, Rye Brook, NY 10573

CORPORATE GOVERNANCE

Copies of the ITT Code of Conduct, Corporate Governance Principles and Committee Charters are available through our website: www.itt.com.

OMBUDSPERSON PROGRAM

The ITT Ombudsperson Program encourages employees to report possible violations of our Code of Corporate Conduct or other misconduct. The ITT Ombudsperson can be contacted at: (800) 777-1738.

WORLD HEADQUARTERS

ITT Corporation
1133 Westchester Avenue
White Plains, NY 10604
Tel: (914) 641-2000
www.itt.com

FOR GENERAL CORPORATE INFORMATION, CONTACT:

Kathleen Bark
Director, External Affairs
kathleen.bark@itt.com

FOR FINANCIAL AND INDUSTRY INFORMATION, CONTACT:

Melissa Trombetta
Director, Investor Relations
melissa.trombetta@itt.com

FOR A COPY OF THE 2011 ANNUAL REPORT ON FORM 10-K, CONTACT:

Elizabeth O'Driscoll
Manager, Stock Administration
elizabeth.odriscoll@itt.com

Design: Eisenman Associates Printing: EarthColor Executive Photography: Jim Schnepf, Jim Koch

ITT

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1133 Westchester Avenue
White Plains, NY 10604
(914) 641-2000

www.itt.com

Print this report

Corporation Details

Corporation Details	
Entity Number	410367
Business Name	KAO USA INC.
Filing Type	FOREIGN CORPORATION
Status	Active
Original Filing Date	05/10/1971
Expiry Date	
Location:	County: State: DELAWARE

Agent / Registrant Information

C T CORP
1300 E 9TH ST
CLEVELAND,OH 441140000
Effective Date: 04/12/1989
Contact Status: Active

Filings

Filing Type	Date of Filing	Document Number/Image
MERGER/LICENSING FOREIGN CORP/FOR PROFIT	05/10/1971	B740_0231
MISCELLANEOUS FILING	05/10/1971	B740_0231
FORM 7 NO FEE ASSESSED	01/01/1976	000000080559
FORM 7 NO FEE ASSESSED	01/01/1977	E329_1605
FORM 7 NO FEE ASSESSED	01/01/1978	E495_0384
FORM 7 NO FEE ASSESSED	01/01/1979	E662_1299
MERGER/FOREIGN	06/09/1980	E763_2007
MERGER/FOREIGN	08/16/1985	F730_0866
FORM 7 NO FEE ASSESSED	01/01/1988	000000080560
FOREIGN/AGENT CHANGE OF ADDRESS	05/16/1988	G442_0310
FOREIGN/DESIGNATED APPOINTMENT OF AGENT	04/12/1989	G604_0298
FORM 7 NO FEE ASSESSED	10/16/1989	F921_0690
FORM 7 NO FEE ASSESSED	12/31/1989	F925_0024
FORM 7 NO FEE ASSESSED	12/31/1990	H002_0515
FORM 7 NO FEE ASSESSED	12/31/1991	H007_1615
FORM 7 NO FEE ASSESSED	01/13/1994	9419_1118
FORM 7 NO FEE ASSESSED	11/28/1994	5012_0207
FORM 7 NO FEE ASSESSED	12/28/1995	5417_1054
FORM 7 NO FEE ASSESSED	10/08/1996	5899_0939
FORM 7 NO FEE ASSESSED	10/17/1997	6091_0193
FOREIGN/AGENT CHANGE OF ADDRESS	05/08/1998	199927501222
FICTITIOUS NAME/ORIGINAL FILING	06/01/2004	200415303274
FOREIGN/AMENDMENT	09/07/2004	200425701782
FOREIGN/AMENDMENT	01/09/2012	201201201047

Old Names

Effective Date	Old Name
09/07/2004	THE ANDREW JERGENS COMPANY
01/09/2012	KAO BRANDS COMPANY

DATE:	DOCUMENT ID	DESCRIPTION	FILING	EXPED	PENALTY	CERT	COPY
09/14/2004	200425701782	FOREIGN/AMENDMENT (FAM)	50.00	.00	.00	.00	.00

Receipt
This is not a bill. Please do not remit payment.

TIMOTHY ROBERSON
17 S. HIGHS ST.
COLUMBUS, OH 43215

STATE OF OHIO
CERTIFICATE
Ohio Secretary of State, J. Kenneth Blackwell

410367

It is hereby certified that the Secretary of State of Ohio has custody of the business records for

KAO BRANDS COMPANY

and, that said business records show the filing and recording of:

Document(s)	Document No(s):
FOREIGN/AMENDMENT	**200425701782**

United States of America
State of Ohio
Office of the Secretary of State

Witness my hand and the seal of the Secretary of State at Columbus, Ohio this 7th day of September, A.D. 2004.

J. Kenneth Blackwell

Ohio Secretary of State

SEP-07-2004 11:13 CT CORPORATION P.02

Prescribed by J. Kenneth Blackwell
Ohio Secretary of State
Central Ohio: (614) 466-3910
Toll Free: 1-877-SOS-FILE (1-877-767-3453)

www.state.oh.us/sos
e-mail: busserv@sos.state.oh.us

Expedite this Form: (Select One)

○ Yes	PO Box 1390 Columbus, OH 43216 — Requires an additional fee of $100 —
○ No	PO Box 1028 Columbus, OH 43216

CERTIFICATE OF AMENDMENT TO FOREIGN CORPORATION APPLICATION FOR LICENSE

(For Foreign, Profit or Non-Profit)
Filing Fee $50.00

(1) ☑ Foreign for Profit License No. 410367 (179-FAM)	(2) ☐ Foreign Non-Profit License No. ______ (179-FAM)

Complete the following information in this section if box (1) or (2) is checked.

The Andrew Jergens Company
(Name of Corporation - Including Assumed Name If Applicable)

Joseph B. Workman, Vice President, does hereby certify that the above named Foreign
(Authorized Officer and Title)

Corporation formed in the state of Delaware
has modified the information set forth in the original Application for License or any Amendment thereto with the following:

The name of the corporation has been amended to

Kao Brands Company

The corporation's principal office shall be located in

2535 Spring Grove Avenue
(street address) NOTE: P.O. Box Addresses are NOT acceptable.

Cincinnati (city, township, or village) Ohio (state) 45214 (zip code)

The corporation's principal office within Ohio shall be located in ☐ Check box if there is no Ohio Location

Cincinnati (city, township, or village) Hamilton (county), Ohio 45214 (zip code)

OH106 - 6/14/2002 C T System Online

Complete the following information in this section if box (1) or (2) is checked Cont.

The corporation will exercise the following corporate purpose(s) in Ohio:

Manufacture and sale of personal care items

This certificate of amendment supersedes the information currently on file with the Secretary of State of Ohio.

This Certificate of Amendment to the Foreign Corporation Application for License has been adopted in accordance with the laws of the state of domestication.

REQUIRED
Must be authenticated (signed) by an authorized representative

Authorized Representative	09/07/2004 Date

DATE:	DOCUMENT ID	DESCRIPTION	FILING	EXPED	PENALTY	CERT	COPY
01/13/2012	201201201047	FOREIGN/AMENDMENT (FAM)	50.00	.00		.00	.00

Receipt

This is not a bill. Please do not remit payment.

CT CORPORATION SYSTEM
4400 EASTON COMMONS WAY, SUITE 125
TIMOTHY ROBERSON
COLUMBUS, OH 43219

STATE OF OHIO
CERTIFICATE
Ohio Secretary of State, Jon Husted

410367

It is hereby certified that the Secretary of State of Ohio has custody of the business records for

KAO USA INC.

and, that said business records show the filing and recording of:

Document(s)	Document No(s):
FOREIGN/AMENDMENT	**201201201047**

United States of America
State of Ohio
Office of the Secretary of State

Witness my hand and the seal of the Secretary of State at Columbus, Ohio this 9th day of January, A.D. 2012.

Jon Husted

Ohio Secretary of State

Prescribed by:

The Ohio Secretary of State
Central Ohio: (614) 466-3910
Toll Free: 1-877-SOS-FILE (1-877-767-3453)

www.sos.state.oh.us
e-mail: busserv@sos.state.oh.us

Expedite this Form: (Select One)

Mail Form to one of the Following:

PO Box 1390
○ Expedite
Columbus, OH 43216
*** Requires an additional fee of $100 ***

PO Box 1329
● Non Expedite
Columbus, OH 43216

CERTIFICATE OF AMENDMENT TO FOREIGN CORPORATION APPLICATION FOR LICENSE

(For Foreign, Profit or Nonprofit)
Filing Fee $50.00

(1) ☒ Foreign for Profit License No. 410367 (179-FAM)	(2) ☐ Foreign Nonprofit License No. ______ (179-FAM)

Complete the following information in this section if box (1) or (2) is checked.

Kao Brands Company
Name of Corporation - Including Assumed Name if Applicable

Joseph H. Workman, Sr. Vice President, does hereby certify that the above named Foreign
Authorized Officer and Title

Corporation formed in the state of Delaware
has modified the information set forth in the original Application for License or any Amendment thereto with the following:

The name of the corporation has been amended to

Kao USA Inc.

The corporation's principal office shall be located in

______
Street Address NOTE: P.O. Box Addresses are NOT acceptable.

______
City, Township, or Village State Zip Code

The corporation's state of formation shall be ______

The corporation's principal office within Ohio shall be located in ☐ Check box if there is no Ohio Location

______
Street Address NOTE: P.O. Box Addresses are NOT acceptable.

______ ______, Ohio ______
City, Township, or Village County Zip Code

RECEIVED
SECRETARY OF STATE
2012 JAN -9 PM 12:39
CLIENT SERVICE CENTER

Complete the following information in this section if box (1) or (2) is checked Cont.

The corporation will exercise the following corporate purpose(s) in Ohio:

This certificate of amendment supersedes the information currently on file with the Secretary of State of Ohio.

This Certificate of Amendment to the Foreign Corporation Application for License has been adopted in accordance with the laws of the state of domestication.

REQUIRED
Must be authenticated (signed) by an authorized representative

Authorized Representative: Joseph B. Workman, Sr. Vice President

Date: January 4, 2012

Delaware

The First State

I, JEFFREY W. BULLOCK, SECRETARY OF STATE OF THE STATE OF DELAWARE DO HEREBY CERTIFY THAT THE ATTACHED IS A TRUE AND CORRECT COPY OF THE CERTIFICATE OF CONVERSION OF A DELAWARE CORPORATION UNDER THE NAME OF "KOEHLER-BRIGHT STAR, INC." TO A DELAWARE LIMITED LIABILITY COMPANY, CHANGING ITS NAME FROM "KOEHLER-BRIGHT STAR, INC." TO "KOEHLER-BRIGHT STAR LLC", FILED IN THIS OFFICE ON THE TWENTY-THIRD DAY OF DECEMBER, A.D. 2009, AT 6:19 O'CLOCK P.M.

AND I DO HEREBY FURTHER CERTIFY THAT THE EFFECTIVE DATE OF THE AFORESAID CERTIFICATE OF CONVERSION IS THE THIRTY-FIRST DAY OF DECEMBER, A.D. 2009, AT 11:59 O'CLOCK P.M.

SECRETARY'S OFFICE 1793 DELAWARE 1855

Jeffrey W. Bullock, Secretary of State

2587878 8100V

091135129

AUTHENTICATION: 7737610

DATE: 01-05-10

State of Delaware
Secretary of State
Division of Corporations
Delivered 06:47 PM 12/23/2009
FILED 06:19 PM 12/23/2009
SRV 091135129 - 2587878 FILE

**CERTIFICATE OF CONVERSION
FROM A CORPORATION TO
A LIMITED LIABILITY COMPANY
PURSUANT TO SECTION 266 OF THE
DELAWARE GENERAL CORPORATION LAW**

This Certificate of Conversion to Limited Liability Company is being executed on the 1st day of December, 2009.

It is certified as follows:

1. The name of the corporation is KOEHLER-BRIGHT STAR, INC.

2. The date of filing of the original Certificate of Incorporation of Koehler-Bright Star, Inc. with the Delaware Secretary of State is January 31, 1996.

3. The name of the limited liability company as set forth in the Certificate of Formation is KOEHLER-BRIGHT STAR LLC.

4. The conversion has been approved in accordance with the provisions of Section 266 of the Delaware General Corporation Law.

5. The conversion shall be effective on December 31, 2009 at 11:59 p.m. Eastern Standard Time.

IN WITNESS WHEREOF, the undersigned has executed this Certificate of Conversion on the day and year first above written.

KOEHLER-BRIGHT STAR, INC.,
a Delaware corporation

By: Mark F. Dirsa

Name: Mark Dirsa
Title: President

Michael P. McThomas, Esq.
MICHAEL P. MCTHOMAS, PLLC
One Lee Hill Road
Andover, New Jersey 07821
Tel: (973) 691-4711
Fax: 973-368-1022

John D. Edgcomb, Esq.
Marylin Jenkins, Esq.
EDGCOMB LAW GROUP
115 Sansome Street, Suite 700
San Francisco, California 94104
Tel.: 415-399-1993
Fax: 415-399-1885

Attorneys for Third-Party Defendant(s)
McKesson Corporation, McKesson Corporation
on behalf of former McKesson subsidiary McKesson
Envirosystems Company, and McKesson Corporation
on behalf of mis-named party Safety-Kleen Systems, Inc.
f/k/a/ Safety-Kleen Corporation

NEW JERSEY DEPARTMENT OF ENVIRONMENTAL PROTECTION, et al, Plaintiffs, vs. OCCIDENTAL CHEMICAL CORPORATION, et al, Defendants, MAXUS ENERGY CORPORATION and TIERRA SOLUTIONS, INC., Third-Party Plaintiffs, vs. AMERICAN CYANAMIC, et al., Third Party Defendants.	SUPERIOR COURT OF NEW JERSEY LAW DIVISION: ESSEX COUNTY DOCKET NO. L-9868-05 (PASR) CIVIL ACTION **CERTIFICATION OF WILLIE C. BOGAN IN SUPPORT OF CMO XII REQUEST FOR EXPEDITED DISMISSAL OF THIRD PARTY DEFENDANTS McKESSON CORPORATION, McKESSON ENVIROSYSTEMS COMPANY, AND SAFETY-KLEEN SYSTEMS , INC. f/k/a/ SAFETY-KLEEN CORPORATION**

I, Willie C. Bogan, do hereby certify as follows:

1. I am Secretary for third-party defendant McKesson Corporation ("McKesson"). I am familiar with the facts of this case and the allegations asserted by third-party plaintiffs. I submit this certification in support of the request by McKesson, McKesson Envirosystems Corporation ("MEC"") and Safety-Kleen Systems f/k/a/ Safety-Kleen Corp. ("SK") for dismissal of all claims against them, in accordance with paragraph 15 of Case Management Order XII ("CMO XII").

2. I am informed and believe that from the mid 1800s to the mid 1930s, the Doremus Avenue site which is referenced in Cross-Complaint "D", was owned and operated by Balbach Smelting and Refining Company.

3. I am informed and believe that from approximately 1951 to approximately 1963, the Doremus Avenue site was owned and operated by Kolker Chemical.

4. I am informed and believe, that from approximately 1963 to May 1974, the Doremus Avenue site was owned and operated by Vulcan Materials Company.

5. I am informed and believe that from May 1974 to December 1981, the Doremus Avenue site was owned and operated by Inland Chemical Corporation.

6. I am informed and believe, based on McKesson's business records, that in December 1981, McKesson Corporation purchased Inland Chemical Corporation and merged it into a wholly-owned subsidiary named MEC. From December 1981 to March 1987, the Doremus Avenue site was owned and operated by MEC.

7. I am informed and believe, based on McKesson's business records, that in March 1987, McKesson sold all of the issued and outstanding shares of common stock of MEC to Nucer

Inc. ("Nucer") a former wholly-owned subsidiary of SK. Subsequent to March 31, 1987, Nucer and MEC merged into a new corporation named Safety-Kleen Envirosystems Corporation ("SKEC"). Upon such merger, SKEC succeeded to the rights and obligations of Nucer and MEC with respect to the Doremus Avenue site.

8. Neither SK nor SKEC ever owned or operated the Doremus Avenue Site. Title to the property was transferred to McKesson at the same time as MEC became SKEC. In addition, McKesson agreed to indemnify SKEC for any claims related to the Doremus Avenue Site. A true copy of the Stock Purchase Agreement, dated March 31, 1987, is attached hereto as Exhibit A.

9. From March 31, 1987 to the present, the Doremus Avenue site has been owned by McKesson Corporation.

I hereby certify that the foregoing statements made by me are true. I am aware that if any of the foregoing statements made by me are willfully false, I am subject to punishment.

By: Willie C. Bogan
Willie C. Bogan

Dated: September 2, 2010

As filed with the Securities and Exchange Commission on February 28, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549

FORM 10-K

(MARK ONE)

☑ **Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the Fiscal Year Ended December 31, 2012

or

☐ **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the transition period from ________ to ________

Commission File No. 1-6571

Merck & Co., Inc.

One Merck Drive
Whitehouse Station, N. J. 08889-0100
(908) 423-1000

Incorporated in New Jersey *I.R.S. Employer Identification No. 22-1918501*

Securities Registered pursuant to Section 12(b) of the Act:

Title of Each Class	*Name of Each Exchange on which Registered*
Common Stock ($0.50 par value)	New York Stock Exchange

Number of shares of Common Stock ($0.50 par value) outstanding as of January 31, 2013: 3,022,367,538.

Aggregate market value of Common Stock ($0.50 par value) held by non-affiliates on June 30, 2012 based on closing price on June 30, 2012: $126,837,000,000.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. **Yes** ☑ **No** ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. **Yes** ☐ **No** ☑

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. **Yes** ☑ **No** ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). **Yes** ☑ **No** ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

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

Large accelerated filer ☑ Accelerated filer ☐ Non-accelerated filer ☐ (Do not check if a smaller reporting company) Smaller reporting company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☑

Documents Incorporated by Reference:

Document	*Part of Form 10-K*
Proxy Statement for the Annual Meeting of Shareholders to be held May 28, 2013, to be filed with the Securities and Exchange Commission within 120 days after the close of the fiscal year covered by this report	Part III

Table of Contents

PART I

Item 1. Business.

Merck & Co., Inc. (“Merck” or the “Company”) is a global health care company that delivers innovative health solutions through its prescription medicines, vaccines, biologic therapies, animal health, and consumer care products, which it markets directly and through its joint ventures. The Company’s operations are principally managed on a products basis and are comprised of four operating segments, which are the Pharmaceutical, Animal Health, Consumer Care and Alliances segments, and one reportable segment, which is the Pharmaceutical segment. The Pharmaceutical segment includes human health pharmaceutical and vaccine products marketed either directly by the Company or through joint ventures. Human health pharmaceutical products consist of therapeutic and preventive agents, generally sold by prescription, for the treatment of human disorders. The Company sells these human health pharmaceutical products primarily to drug wholesalers and retailers, hospitals, government agencies and managed health care providers such as health maintenance organizations, pharmacy benefit managers and other institutions. Vaccine products consist of preventive pediatric, adolescent and adult vaccines, primarily administered at physician offices. The Company sells these human health vaccines primarily to physicians, wholesalers, physician distributors and government entities. The Company also has animal health operations that discover, develop, manufacture and market animal health products, including vaccines, which the Company sells to veterinarians, distributors and animal producers. Additionally, the Company has consumer care operations that develop, manufacture and market over-the-counter, foot care and sun care products, which are sold through wholesale and retail drug, food chain and mass merchandiser outlets, as well as club stores and specialty channels.

For financial information and other information about the Company’s segments, see Item 7. “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and Item 8. “Financial Statements and Supplementary Data” below.

All product or service marks appearing in type form different from that of the surrounding text are trademarks or service marks owned, licensed to, promoted or distributed by Merck, its subsidiaries or affiliates, except as noted. All other trademarks or services marks are those of their respective owners.

Overview

Merck continued to execute on its strategic priorities during 2012 despite facing several business challenges, including the August U.S. patent expiration for *Singulair* (montelukast), a medicine indicated for the chronic treatment of asthma and the relief of symptoms of allergic rhinitis. Worldwide sales were $47.3 billion in 2012, a decline of 2% compared with 2011, including a 3% unfavorable effect from foreign exchange. Excluding the impact of foreign exchange, sales increased 1% reflecting growth of key products and within key geographic regions which offset the impact of the U.S. *Singulair* patent expiration. The Company also reduced operating expenses by efficiently managing costs through targeted reductions. In addition, the Company generated new clinical data and advanced certain key research and development pipeline programs.

The Company’s four-part growth strategy is focused on; one, executing on its core business, which includes its largest markets, its core brands, new launch brands, and research and development efforts targeted at therapeutic areas with the greatest future patient demand and scientific opportunity; two, expanding geographically into high-growth markets; three, extending into complementary businesses of consumer care and animal health; and four, effectively managing costs while continuing to invest for future growth.

Beginning with the Company’s sales performance in its largest markets during 2012, despite the adverse effects of the U.S. *Singulair* patent expiry which caused a significant and rapid decline in U.S. *Singulair* sales, sales in the United States were relatively flat compared to the prior year reflecting strong growth of key brands including *Januvia* (sitagliptin) and *Janumet* (sitagliptin/metformin HCI), treatments for type 2 diabetes, *Zostavax* (Zoster Vaccine Live), a vaccine to help prevent shingles (herpes zoster), *Gardasil* (Human Papillomavirus Quadrivalent [Types 6, 11, 16 and 18] Vaccine, Recombinant), a vaccine to help prevent certain diseases caused by four types of human papillomavirus (“HPV”), *Victrelis* (boceprevir), a treatment for chronic hepatitis C, and *Isentress* (raltegravir), an antiretroviral therapy for use in combination therapy for the treatment of HIV-1 infection. Turning to Europe and Canada, the Company continues to experience positive volume growth trends for many of its key brands, including *Victrelis, Januvia*, *Janumet*, and *Simponi* (golimumab), a treatment for inflammatory diseases; however, this growth only partially offset increased generic erosion and the price declines stemming from the economic issues and related fiscal austerity measures in this region.

With respect to research and development efforts, the Company continued the advancement of drug candidates through its pipeline in 2012. The Company currently has three candidates under review with the U.S. Food and Drug Administration (the "FDA"): MK-4305, suvorexant, an investigational treatment for insomnia; MK-8616, sugammadex sodium injection, a medication for the reversal of certain muscle relaxants used during surgery; and MK-0653C, an investigational combination of ezetimibe and atorvastatin for the treatment of primary or mixed hyperlipidemia. MK-8109, vintafolide, an investigational cancer candidate, is under review in the European Union (the "EU"). In addition, the Company currently has 16 candidates in Phase III development and anticipates filing a New Drug Application ("NDA") or a Biologics License Application ("BLA"), as applicable, with the FDA with respect to several of these candidates in 2013.

In December 2012, the Company announced the HPS2-THRIVE (Heart Protection Study 2-Treatment of HDL to Reduce the Incidence of Vascular Events) study of *Tredaptive* (extended-release niacin/laropipant) did not meet its primary endpoint. As a result, the Company does not plan to seek regulatory approval for the medicine in the United States. In January 2013, Merck began taking steps to suspend the availability of *Tredaptive* outside the United States. Also, on February 1, 2013, the Company announced that it had recently received and was reviewing safety and efficacy data from a Phase III study involving MK-0822, odanacatib, the Company's investigational treatment for osteoporosis in post-menopausal women. As a result of its review of this data, the Company concluded that review of additional data from the previously planned, ongoing extension study was warranted and that filing an application for approval with the FDA should be delayed. As previously announced, the Company is conducting a blinded extension of the trial in approximately 8,200 women, which will provide additional safety and efficacy data. Merck now anticipates that it will file applications for approval of odanacatib in 2014 with additional data from the extension trial. The Company continues to believe that odanacatib will have the potential to address unmet medical needs in patients with osteoporosis.

Merck continues to pursue opportunities for establishing external alliances to complement its substantial internal research capabilities, including research collaborations, as well as licensing preclinical and clinical compounds and technology platforms that have the potential to drive both near- and long-term growth. During 2012, the Company completed a variety of transactions spanning different therapeutic areas and clinical stages including licensing agreements with Endocyte, Inc. ("Endocyte") for vintafolide (MK-8109), an investigational cancer candidate, and with AiCuris for a portfolio of investigational medicines targeting human cytomegalovirus, including letermovir (MK-8228).

Consistent with the second element of the Company's strategy to expand geographically in high-growth markets such as Japan and key emerging markets, the Company continued to invest in these markets in 2012. Emerging market sales grew 4% in 2012, including a 4% unfavorable impact of foreign exchange, despite the loss of sales from *Remicade* (infliximab) and *Simponi*, treatments for inflammatory diseases, in markets relinquished to Johnson & Johnson ("J&J") as part of the arbitration settlement agreement in 2011 as discussed below. China continues to be an important growth driver with sales exceeding $1.0 billion in 2012, representing growth of 25% over the prior year, including a 3% favorable effect from foreign exchange. Growth in Japan was 6% during 2012, tempered by generic competition and the biennial price cuts early in the year. Merck has entered into several transactions designed to strengthen its presence in the emerging markets in the longer term. The Company's joint venture with Simcere Pharmaceutical Group in China began preliminary operations in late-2012.

The third component of Merck's strategy relates to the complementary businesses of Consumer Care and Animal Health. Merck's Animal Health business continues as a solid contributor with 4% revenue growth in 2012, including a 5% unfavorable effect from foreign exchange, reflecting growth in the cattle, poultry, companion animal and swine product lines. Sales of Consumer Care products grew 6% in 2012, including a 1% unfavorable effect from foreign exchange, led by the *Dr. Scholl's* franchise and higher sales of *Coppertone*, *MiraLAX* and *Claritin*.

As noted, the last element of the Company's strategy is to tightly manage costs while also investing for growth. Consistent with these efforts, Merck remains committed to driving continuous productivity improvements across the enterprise and continues to realize cost savings across all areas of the Company. These savings result from various actions, including the Merger Restructuring Program discussed below, previously announced ongoing cost reduction activities, as well as from non-restructuring-related activities. As of the end of 2012, the Company had achieved its projected $3.5 billion in annual net cost savings from these activities since the merger with Schering-Plough Corporation ("Schering-Plough") (the "Merger").

The global restructuring program that was initiated in conjunction with the integration of the legacy Merck and legacy Schering-Plough businesses (the "Merger Restructuring Program") is intended to optimize the cost structure of the combined company. The workforce reductions associated with this plan relate to the elimination of positions in sales, administrative and headquarters organizations, as well as from the sale or closure of certain manufacturing and research and development sites and the consolidation of office facilities. The Company recorded total pretax restructuring costs of $951 million in 2012, $1.8 billion in 2011 and $1.8 billion in 2010 related to this program. Costs associated with the Company's restructuring actions are included in *Materials and production* costs, *Marketing and administrative* expenses, *Research and development* expenses and *Restructuring costs*. The restructuring actions under the Merger Restructuring Program are expected to be substantially completed by the end of 2013, with the exception of certain actions, principally manufacturing-related. Subsequent to the Merger, the Company has rationalized a number of manufacturing sites worldwide. The remaining actions under this program will result in additional manufacturing facility rationalizations, which are expected to be substantially completed by 2016. The Company now expects the estimated total cumulative pretax costs for this program to be approximately $7.2 billion to $7.5 billion. The Company estimates that approximately two-thirds of the cumulative pretax costs relate to cash outlays, primarily related to employee separation expense. Approximately one-third of the cumulative pretax costs are non-cash, relating primarily to the accelerated depreciation of facilities to be closed or divested. The Company expects the Merger Restructuring Program to yield annual savings by the end of 2013 of approximately $3.5 billion to $4.0 billion and annual savings upon completion of the program of approximately $4.0 billion to $4.6 billion.

In November 2012, Merck's Board of Directors raised the Company's quarterly dividend to $0.43 per share from $0.42 per share.

In February 2013, Merck reached an agreement in principle with plaintiffs to resolve two federal securities class-action lawsuits pending in the U.S. District Court for the District of New Jersey against Merck, Schering-Plough and certain of their current and former officers and directors (the "ENHANCE Litigation"). Under the proposed agreement, Merck will pay $215 million to resolve the securities class action against all of the Merck defendants and $473 million to resolve the securities class action against all of the Schering-Plough defendants. In connection with the settlement, Merck recorded a pretax and after-tax charge of $493 million in 2012 which reflects $195 million of anticipated insurance recoveries.

Earnings per common share assuming dilution attributable to common shareholders ("EPS") for 2012 were $2.00, which reflect a net unfavorable impact resulting from acquisition-related costs and restructuring costs, as well as the charge related to the ENHANCE Litigation noted above. Non-GAAP EPS in 2012 were $3.82 excluding these items (see "Non-GAAP Income and Non-GAAP EPS" below).

Product Sales

Sales of the Company's products were as follows:

($ in millions)	**2012**	2011	2010
Primary Care and Women's Health			
Cardiovascular			
Zetia	**$ 2,567**	$ 2,428	$ 2,297
Vytorin	**1,747**	1,882	2,014
Diabetes and Obesity			
Januvia	**4,086**	3,324	2,385
Janumet	**1,659**	1,363	954
Respiratory			
Singulair	**3,853**	5,479	4,987
Nasonex	**1,268**	1,286	1,219
Clarinex	**393**	621	623
Dulera	**207**	96	8
Asmanex	**185**	206	208
Women's Health and Endocrine			
Fosamax	**676**	855	926
NuvaRing	**623**	623	559
Follistim AQ	**468**	530	528
Implanon	**348**	294	236
Cerazette	**271**	268	209
Other			
Maxalt	**638**	639	550
Arcoxia	**453**	431	398
Avelox	**201**	322	316
Hospital and Specialty			
Immunology			
Remicade	**2,076**	2,667	2,714
Simponi	**331**	264	97
Infectious Disease			
Isentress	**1,515**	1,359	1,090
PegIntron	**653**	657	737
Cancidas	**619**	640	611
Victrelis	**502**	140	—
Invanz	**445**	406	362
Primaxin	**384**	515	610
Noxafil	**258**	230	198
Oncology			
Temodar	**917**	935	1,065
Emend	**489**	419	378
Other			
Cosopt/Trusopt	**444**	477	484
Bridion	**261**	201	103
Integrilin	**211**	230	266
Diversified Brands			
Cozaar/Hyzaar	**1,284**	1,663	2,104
Propecia	**424**	447	447
Zocor	**383**	456	468
Claritin Rx	**244**	314	296
Remeron	**232**	241	223
Proscar	**217**	223	216
Vasotec/Vaseretic	**192**	231	255
Vaccines [(1)]			
Gardasil	**1,631**	1,209	988
ProQuad/M-M-R II/Varivax	**1,273**	1,202	1,378
Zostavax	**651**	332	243
RotaTeq	**601**	651	519
Pneumovax	**580**	498	376
Other pharmaceutical[(2)]	**4,141**	4,035	4,622
Total Pharmaceutical segment sales	**40,601**	41,289	39,267
Other segment sales[(3)]	**6,412**	6,428	6,159
Total segment sales	**47,013**	47,717	45,426
Other[(4)]	**254**	330	561
	$47,267	$48,047	$45,987

[(1)] *These amounts do not reflect sales of vaccines sold in most major European markets through the Company's joint venture, Sanofi Pasteur MSD, the results of which are reflected in* Equity income from affiliates*. These amounts do, however, reflect supply sales to Sanofi Pasteur MSD.*

[(2)] *Other pharmaceutical primarily reflects sales of other human health pharmaceutical products, including products within the franchises not listed separately.*

[(3)] *Reflects the non-reportable segments of Animal Health, Consumer Care and Alliances. The Alliances segment includes revenue from the Company relationship with AZLP.*

[(4)] *Other revenues are primarily comprised of miscellaneous corporate revenues, third-party manufacturing sales, sales related to divested products or businesses and other supply sales not included in segment results.*

Pharmaceutical

The Company's pharmaceutical products include therapeutic and preventive agents, generally sold by prescription, for the treatment of human disorders. Certain of the products within the Company's franchises are as follows:

Primary Care and Women's Health

Cardiovascular: *Zetia* (marketed as *Ezetrol* outside the United States); and *Vytorin* (ezetimibe/simvastatin) (marketed as *Inegy* outside the United States), cholesterol modifying medicines.

Diabetes and Obesity: *Januvia* and *Janumet* for the treatment of type 2 diabetes.

Respiratory: *Singulair*; *Nasonex* (mometasone furoate monohydrate), an inhaled nasal corticosteroid for the treatment of nasal allergy symptoms; *Clarinex* (desloratadine), a non-sedating antihistamine; *Dulera* Inhalation Aerosol (mometasone furoate/formoterol fumarate dihydrate), a combination medicine for the treatment of asthma; and *Asmanex Twisthaler* (mometasone furoate inhalation powder), an inhaled corticosteroid for first-line maintenance treatment of asthma in patients 4 years of age and older.

Women's Health and Endocrine: *Fosamax* (alendronate sodium) for the treatment and prevention of osteoporosis; *NuvaRing* (etonogestrel/ethinyl estradiol vaginal ring), a vaginal contraceptive ring; *Follistim AQ* (follitropin beta injection), a biological fertility treatment; *Implanon* (etonogestrel implant), a single-rod subdermal contraceptive implant; and *Cerazette* (desogestrel), a progestin only oral contraceptive.

Other: *Maxalt* (rizatriptan benzoate), a product for acute treatment of migraine; *Arcoxia* (etoricoxib) for the treatment of arthritis and pain; and *Avelox* (moxifloxacin), which the Company only markets in the United States, a broad-spectrum fluoroquinolone antibiotic for the treatment of certain respiratory and skin infections.

Hospital and Specialty

Immunology: *Remicade* and *Simponi* for the treatment of inflammatory diseases.

Infectious Disease: *Isentress*; *PegIntron* (peginterferon alpha-2b), a treatment for chronic hepatitis C; *Cancidas* (caspofungin acetate), an anti-fungal product; *Victrelis*; *Invanz* (ertapenem sodium) for the treatment of certain infections; *Primaxin* (imipenem and cilastatin sodium), an anti-bacterial product; and *Noxafil* (posaconazole) for the prevention of invasive fungal infections.

Oncology: *Temodar* (temozolomide) (marketed as *Temodal* outside the United States), a treatment for certain types of brain tumors; and *Emend* (aprepitant) for the prevention of chemotherapy-induced and post-operative nausea and vomiting.

Other: *Cosopt* (dorzolamide hydrochloride-timolol maleate ophthalmic solution) and *Trusopt* (dorzolamide hydrochloride ophthalmic solution), ophthalmic products; *Bridion* (sugammadex sodium injection), a medication for the reversal of certain muscle relaxants used during surgery; and Integrilin (eptifibatide), a treatment for patients with acute coronary syndrome.

Diversified Brands

Cozaar (losartan potassium) and *Hyzaar* (losartan potassium and hydrochlorothiazide), treatments for hypertension; *Propecia* (finasteride), a product for the treatment of male pattern hair loss; *Zocor* (simvastatin), a statin for modifying cholesterol; *Claritin Rx* (loratadine) for treatment of seasonal outdoor allergies and year-round indoor allergies; *Remeron* (mirtazapine), an antidepressant; *Proscar* (finasteride), a urology product for the treatment of symptomatic benign prostate enlargement; and *Vasotec* (enalapril maleate) and *Vaseretic* (enalapril maleate-hydrochlorothiazide), hypertension and/or heart failure products.

Vaccines

Gardasil; ProQuad (Measles, Mumps, Rubella and Varicella Virus Vaccine Live), a pediatric combination vaccine to help protect against measles, mumps, rubella and varicella; *M-M-R* II (Measles, Mumps and Rubella Virus Vaccine Live), a vaccine to help prevent measles, mumps and rubella; *Varivax* (Varicella Virus Vaccine Live), a vaccine to help prevent chickenpox (varicella); *Zostavax; RotaTeq* (Rotavirus Vaccine, Live Oral, Pentavalent), a vaccine to help protect against rotavirus gastroenteritis in infants and children; and *Pneumovax* (pneumococcal vaccine polyvalent), a vaccine to help prevent pneumococcal disease.

Animal Health

The Animal Health segment discovers, develops, manufactures and markets animal health products, including vaccines. Principal marketed products in this segment include:

Livestock Products: *Nuflor* antibiotic range for use in cattle and swine; *Bovilis*/*Vista* vaccine lines for infectious diseases in cattle; *Banamine* bovine and swine anti-inflammatory; *Estrumate* for the treatment of fertility disorders in cattle; *Regumate*/*Matrix* fertility management for swine and horses; *Resflor* combination broad-spectrum antibiotic and non-steroidal anti-inflammatory drug for bovine respiratory disease; *Zuprevo* for bovine respiratory disease; *Zilmax* and *Revalor* to improve production efficiencies in beef cattle; *M+Pac* swine pneumonia vaccine; and *Porcilis* vaccine line for infectious diseases in swine.

Poultry Products: *Nobilis*/*Innovax,* vaccine lines for poultry; and *Paracox* and *Coccivac* coccidiosis vaccines.

Companion Animal Products: *Nobivac*/*Continuum* vaccine lines for flexible dog and cat vaccination; *Otomax*/*Mometamax*/*Posatex* ear ointments for acute and chronic otitis; *Caninsulin*/*Vetsulin* diabetes mellitus treatment for dogs and cats; *Panacur*/*Safeguard* broad-spectrum anthelmintic (de-wormer) for use in many animals; and *Activyl/Scalibor/Exspot* for protecting against bites from fleas, ticks, mosquitoes and sandflies.

Aquaculture Products: *Slice* parasiticide for sea lice in salmon; *Aquavac*/*Norvax* vaccines against bacterial and viral disease in fish; *Compact PD* vaccine for salmon; and *Aquaflor* antibiotic for farm-raised fish.

Consumer Care

The Consumer Care segment develops, manufactures and markets over-the-counter, foot care and sun care products. Principal products in this segment include:

Over-the-Counter Products: *Claritin* non-drowsy antihistamines; *MiraLAX* for relief of occasional constipation; *Coricidin HBP* decongestant-free cold/flu medicine for people with high blood pressure; *Afrin* nasal decongestant spray; and *Zegerid OTC* treatment for frequent heartburn.

Foot Care: *Dr. Scholl's* foot care products; *Lotrimin* topical antifungal products; and *Tinactin* topical antifungal products and foot and sneaker odor/wetness products.

Sun Care: *Coppertone* sun care lotions, sprays and dry oils.

For a further discussion of sales of the Company's products, see Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" below.

Product Approvals

In February 2012, the FDA approved *Zioptan* (tafluprost), a preservative-free prostaglandin analog ophthalmic solution for reducing elevated intraocular pressure in patients with open-angle glaucoma or ocular hypertension. Merck has exclusive commercial rights to tafluprost in Western Europe (excluding Germany), North America, South America, Africa, the Middle East, India and Australia. *Zioptan* is marketed as *Saflutan* in certain markets outside the United States. Also, in February 2012, the FDA approved *Janumet XR*, a new treatment for type 2 diabetes that combines sitagliptin, which is the active component of *Januvia*, with extended-release metformin. *Janumet XR* provides a convenient once-daily treatment option for health care providers and patients who need help to control their blood sugar. In addition, in February 2012, the FDA approved *Cosopt PF*, Merck's preservative-free formulation of *Cosopt* ophthalmic solution, indicated for the reduction of elevated intraocular pressure in appropriate patients with open-angle glaucoma or ocular hypertension.

Joint Ventures

AstraZeneca LP

In 1982, Merck entered into an agreement with Astra AB ("Astra") to develop and market Astra products in the United States. In 1994, Merck and Astra formed an equally owned joint venture that developed and marketed most of Astra's new prescription medicines in the United States including Prilosec (omeprazole), the first in a class of medications known as proton pump inhibitors, which slows the production of acid from the cells of the stomach lining.

In 1998, Merck and Astra restructured the joint venture whereby Merck acquired Astra's interest in the joint venture, renamed KBI Inc. ("KBI"), and contributed KBI's operating assets to a new U.S. limited partnership named Astra Pharmaceuticals, L.P. (the "Partnership"), in exchange for a 1% limited partner interest. Astra contributed the net assets of its wholly owned subsidiary, Astra USA, Inc., to the Partnership in exchange for a 99% general partner interest. The Partnership, renamed AstraZeneca LP ("AZLP") upon Astra's 1999 merger with Zeneca Group Plc, became the exclusive distributor of the products for which KBI retained rights.

The Company earns certain Partnership returns as well as ongoing revenue based on sales of current and future KBI products. The Partnership returns include a priority return provided for in the Partnership Agreement, a preferential return representing the Company's share of undistributed Partnership AZLP generally accepted accounting principles ("GAAP") earnings, and a variable return related to the Company's 1% limited partner interest.

In conjunction with the 1998 restructuring discussed above, Astra purchased an option (the "Asset Option") for a payment of $443 million, which was recorded as deferred income, to buy Merck's interest in the KBI products, excluding the gastrointestinal medicines Nexium and Prilosec (the "Non-PPI Products"). In April 2010, AstraZeneca exercised the Asset Option. Merck received $647 million from AstraZeneca representing the net present value as of March 31, 2008 of projected future pretax revenue to be received by Merck from the Non-PPI Products, which was recorded as a reduction to the Company's investment in AZLP. The Company recognized the $443 million of deferred income in 2010 as a component of *Other (income) expense, net*. In addition, in 1998, Merck granted Astra an option to buy Merck's common stock interest in KBI and, through it, Merck's interest in Nexium and Prilosec as well as AZLP, exercisable in 2012. In June 2012, Merck and AstraZeneca amended the 1998 option agreement. The updated agreement eliminated AstraZeneca's option to acquire Merck's interest in KBI in 2012 and provides AstraZeneca a new option to acquire Merck's interest in KBI in June 2014. As a result of the amended agreement, Merck continues to record supply sales and equity income from the partnership. In 2014, AstraZeneca has the option to purchase Merck's interest in KBI based in part on the value of Merck's interest in Nexium and Prilosec. AstraZeneca's option is exercisable between March 1, 2014 and April 30, 2014. If AstraZeneca chooses to exercise this option, the closing date is expected to be June 30, 2014. Under the amended agreement, AstraZeneca will make a payment to Merck upon closing of $327 million, reflecting an estimate of the fair value of Merck's interest in Nexium and Prilosec. This portion of the exercise price is subject to a true-up in 2018 based on actual sales from closing in 2014 to June 2018. The exercise price will also include an additional amount equal to a multiple of ten times Merck's average 1% annual profit allocation in the partnership for the three years prior to exercise. The Company believes that it is likely that AstraZeneca will exercise its option in 2014. If AstraZeneca exercises its option, the Company will no longer record equity income from AZLP and supply sales to AZLP will decline substantially.

Sanofi Pasteur MSD

In 1994, Merck and Pasteur Mérieux Connaught (now Sanofi Pasteur S.A.) formed a joint venture to market human vaccines in Europe and to collaborate in the development of combination vaccines for distribution in the then-existing EU and the European Free Trade Association. Merck and Sanofi Pasteur contributed, among other things, their European vaccine businesses for equal shares in the joint venture, known as Pasteur Mérieux MSD, S.N.C. (now Sanofi Pasteur MSD, S.N.C.). The joint venture maintains a presence, directly or through affiliates or branches, in Belgium, Italy, Germany, Spain, France, Austria, Ireland, Sweden, Portugal, the Netherlands, Switzerland and the United Kingdom and through distributors in the rest of its territory.

Licenses

In 1998, a subsidiary of Schering-Plough entered into a licensing agreement with Centocor Ortho Biotech Inc. ("Centocor"), a J&J company, to market *Remicade*, which is prescribed for the treatment of inflammatory diseases. In 2005, Schering-Plough's subsidiary exercised an option under its contract with Centocor for license rights to develop and commercialize *Simponi*, a fully human monoclonal antibody. The Company had exclusive marketing rights to both products outside the United States, Japan and certain other Asian markets. In December 2007, Schering-Plough and Centocor revised their distribution agreement regarding the development, commercialization and distribution of both *Remicade* and *Simponi*, extending the Company's rights to exclusively market *Remicade* to match the duration of the Company's exclusive marketing rights for *Simponi*. In addition, Schering-Plough and Centocor agreed to share certain development costs relating to *Simponi*'s auto-injector delivery system. On October 6, 2009, the European Commission ("EC") approved *Simponi* as a treatment for rheumatoid arthritis and other immune system disorders in two presentations — a novel auto-injector and a prefilled syringe. As a result, the Company's marketing rights for both products extend for 15 years from the first commercial sale of *Simponi* in the EU following the receipt of pricing and reimbursement approval within the EU.

In April 2011, Merck and J&J reached an agreement to amend the agreement governing the distribution rights to *Remicade* and *Simponi*. Under the terms of the amended distribution agreement, Merck relinquished marketing rights for *Remicade* and *Simponi* to J&J in territories including Canada, Central and South America, the Middle East, Africa and Asia Pacific effective July 1, 2011. Merck retained exclusive marketing rights throughout Europe, Russia and Turkey (the "Retained Territories"). In addition, beginning July 1, 2011, all profits derived from Merck's exclusive distribution of the two products in the Retained Territories are being equally divided between Merck and J&J. J&J also received a one-time payment from Merck of $500 million in April 2011.

Competition and the Health Care Environment

Competition

The markets in which the Company conducts its business and the pharmaceutical industry are highly competitive and highly regulated. The Company's competitors include other worldwide research-based pharmaceutical companies, smaller research companies with more limited therapeutic focus, and generic drug and consumer health care manufacturers. The Company's operations may be affected by technological advances of competitors, industry consolidation, patents granted to competitors, competitive combination products, new products of competitors, the generic availability of competitors' branded products, new information from clinical trials of marketed products or post-marketing surveillance and generic competition as the Company's products mature. In addition, patent positions are increasingly being challenged by competitors, and the outcome can be highly uncertain. An adverse result in a patent dispute can preclude commercialization of products or negatively affect sales of existing products and could result in the recognition of an impairment charge with respect to certain products. Competitive pressures have intensified as pressures in the industry have grown. The effect on operations of competitive factors and patent disputes cannot be predicted.

Pharmaceutical competition involves a rigorous search for technological innovations and the ability to market these innovations effectively. With its long-standing emphasis on research and development, the Company is well positioned to compete in the search for technological innovations. Additional resources required to meet market challenges include quality control, flexibility to meet customer specifications, an efficient distribution system and a strong technical information service. The Company is active in acquiring and marketing products through external alliances, such as joint ventures and licenses, and has been refining its sales and marketing efforts to further address changing industry conditions. However, the introduction of new products and processes by competitors may result in price reductions and product displacements, even for products protected by patents. For example, the number of compounds available to treat a particular disease typically increases over time and can result in slowed sales growth for the Company's products in that therapeutic category.

The highly competitive animal health business is affected by several factors including regulatory and legislative issues, scientific and technological advances, product innovation, the quality and price of the Company's products, effective promotional efforts and the frequent introduction of generic products by competitors.

The Company's consumer care operations face competition from other consumer health care businesses as well as retailers who carry their own private label brands. The Company's competitive position is affected by several factors, including regulatory and legislative issues, scientific and technological advances, the quality and price of the Company's products, promotional efforts and the growth of lower cost private label brands.

Health Care Environment

Global efforts toward health care cost containment continue to exert pressure on product pricing and market access. In the United States, federal and state governments for many years also have pursued methods to reduce the cost of drugs and vaccines for which they pay. For example, federal laws require the Company to pay specified rebates for medicines reimbursed by Medicaid and to provide discounts for outpatient medicines purchased by certain Public Health Service entities and hospitals serving a disproportionate share of low income or uninsured patients.

Against this backdrop, the United States enacted major health care reform legislation in 2010, which began to be implemented in 2010. Various insurance market reforms have advanced and will continue through full implementation in 2014. The law is expected to expand access to health care to about 32 million Americans by the end of the decade who did not previously have insurance coverage. With respect to the effect of the law on the pharmaceutical industry, the mandated Medicaid rebate increased from 15.1% to 23.1%, expanded the rebate to Medicaid managed care utilization, and increased the types of entities eligible for the federal 340B drug discount program. The law also requires pharmaceutical manufacturers to pay a 50% point of service discount to Medicare Part D beneficiaries when they are in the Medicare Part D coverage gap (i.e., the so-called "donut hole"). Approximately $210 million and $150 million was recorded by Merck as a reduction to revenue in 2012 and 2011, respectively, related to the donut hole provision. Also, pharmaceutical manufacturers are now required to pay an annual health care reform fee. The total annual industry fee was $2.8 billion in 2012 and will be $2.8 billion in 2013. The fee is assessed on each company in proportion to its share of sales to certain government programs, such as Medicare and Medicaid. The Company recorded $190 million and $162 million of costs within *Marketing and administrative* expenses in 2012 and 2011, respectively, for the annual health care reform fee.

The Company also faces increasing pricing pressure globally from managed care organizations, government agencies and programs that could negatively affect the Company's sales and profit margins. In the United States, these include (i) practices of managed care groups and institutional and governmental purchasers, and (ii) U.S. federal laws and regulations related to Medicare and Medicaid, including the Medicare Prescription Drug Improvement and Modernization Act of 2003 and the Patient Protection and Affordable Care Act of 2010. Changes to the health care system enacted as part of health care reform in the United States, as well as increased purchasing power of entities that negotiate on behalf of Medicare, Medicaid, and private sector beneficiaries, could result in further pricing pressures.

In addition, in the effort to contain the U.S. federal deficit, the pharmaceutical industry could be considered a potential source of savings via legislative proposals that have been debated but not enacted. These types of revenue generating or cost saving proposals include additional direct price controls in the Medicare prescription drug program (Part D). In addition, Congress may again consider proposals to allow, under certain conditions, the importation of medicines from other countries. It remains very uncertain as to what proposals, if any, may be included as part of future federal budget deficit reduction proposals that would directly or indirectly affect the Company.

Efforts toward health care cost containment remain intense in several European countries. Many countries have announced austerity measures, which include the implementation of pricing actions to reduce prices of generic and patented drugs and mandatory switches to generic drugs. While the Company is taking steps to mitigate the impact in the EU, the austerity measures continued to negatively affect the Company's revenue performance in 2012 and the Company anticipates the austerity measures will continue to negatively affect revenue performance in 2013.

Additionally, the global economic downturn and the sovereign debt issues in certain European countries, among other factors, have adversely affected foreign receivables in certain European countries. While the Company continues to receive payment on these receivables, these conditions have resulted in an increase in the average length of time it takes to collect accounts receivable outstanding thereby adversely affecting cash flows.

Governments in many emerging markets are also focused on constraining health care costs and have enacted price controls and related measures that aim to put pressure on the price of pharmaceuticals and constrain market access. The Company anticipates that pricing pressures and market access challenges will continue in 2013 to varying degrees in the emerging markets.

The Company's focus on and share of revenue from emerging markets has increased. Countries in these markets may be subject to conditions that can affect the Company's efforts to continue to grow in emerging markets, including potential political instability, significant currency fluctuation and controls, financial crises, limited or changing availability of funding for health care, and other developments that may adversely impact the business environment for the Company. Further, the Company may engage third-party agents to assist in operating in emerging market countries, which may affect its ability to realize continued growth and may also increase the Company's risk exposure.

The full impact of health care reform, as well as continuing budget pressures on governments around the world, cannot be predicted at this time.

In addressing cost containment pressures, the Company engages in public policy advocacy with policymakers and continues to attempt to demonstrate that its medicines provide value to patients and to those who pay for health care. The Company seeks to work with government policymakers to encourage a long-term approach to sustainable health care financing that ensures access to innovative medicines and does not disproportionately target pharmaceuticals as a source of budget savings. In markets with historically low rates of government health care spending, the Company encourages those governments to increase their investments in order to improve their citizens' access to appropriate health care, including medicines.

Certain markets outside of the United States have implemented health technology assessments and other cost management strategies which require additional data, reviews and administrative processes, all of which increase the complexity and costs of obtaining product reimbursement and exert downward pressure on reimbursement available and obtained.

Operating conditions have become more challenging under the global pressures of competition, industry regulation and cost containment efforts. Although no one can predict the effect of these and other factors on the Company's business, the Company continually takes measures to evaluate, adapt and improve the organization and its business practices to better meet customer needs and believes that it is well positioned to respond to the evolving health care environment and market forces.

Government Regulation

The pharmaceutical industry is subject to regulation by regional, country, state and local agencies around the world. Governmental regulation and legislation tend to focus on standards and processes for determining drug safety and effectiveness, as well as conditions for sale or reimbursement, especially related to the pricing of products.

Of particular importance is the FDA in the United States, which administers requirements covering the testing, approval, safety, effectiveness, manufacturing, labeling, and marketing of prescription pharmaceuticals. In many cases, the FDA requirements and practices have increased the amount of time and resources necessary to develop new products and bring them to market in the United States.

The EU has adopted directives and other legislation concerning the classification, labeling, advertising, wholesale distribution, integrity of the supply chain, enhanced pharmacovigilance monitoring and approval for marketing of medicinal products for human use. These provide mandatory standards throughout the EU, which may be supplemented or implemented with additional regulations by the EU member states. The Company's policies and procedures are already consistent with the substance of these directives; consequently, it is believed that they will not have any material effect on the Company's business.

The Company believes that it will continue to be able to conduct its operations, including launching new drugs, in this regulatory environment.

Access to Medicines

As a global health care company, Merck's primary role is to discover and develop innovative medicines and vaccines. The Company also recognizes that it has an important role to play in helping to improve access to its products around the world. The Company's efforts in this regard are wide-ranging and include a set of principles that the Company strives to embed into its operations and business strategies to guide the Company's worldwide approach to expanding access to health care. For example, the Company has been recognized for pricing many of its products through a differential pricing framework, taking into consideration such factors as a country's level of economic development and public health need. In addition, the Merck Patient Assistance Program provides medicines and adult vaccines for free to people in the United States who do not have prescription drug or health insurance coverage and who, without the Company's assistance, cannot afford their Merck medicine and vaccines.

Building on the Company's own efforts, Merck has undertaken collaborations with many stakeholders to improve access to medicines and enhance the quality of life for people around the world.

For example, in 2011, Merck announced that it would launch "Merck for Mothers," a long-term effort with global health partners to create a world where no woman has to die from preventable complications of pregnancy and childbirth. The launch includes a 10-year, $500 million initiative that applies Merck's scientific and business expertise to making proven solutions more widely available, developing new technologies and improving public awareness, policy efforts and private sector engagement to reduce maternal mortality.

Merck has also in the past provided funds to the Merck Foundation, an independent organization, which has partnered with a variety of organizations dedicated to improving global health. One of these partnerships is The African Comprehensive HIV/AIDS Partnership in Botswana, a collaboration with the government of Botswana that was renewed in 2010 and supports Botswana's response to HIV/AIDS through a comprehensive and sustainable approach to HIV prevention, care, treatment, and support.

Privacy and Data Protection

The Company is subject to a number of privacy and data protection laws and regulations globally. The legislative and regulatory landscape for privacy and data protection continues to evolve. There has been increased attention to privacy and data protection issues in both developed and emerging markets with the potential to affect directly the Company's business, including recently enacted laws and regulations in the United States, Europe, Asia and Latin America and increased enforcement activity in the United States and other developed markets.

Distribution

The Company sells its human health pharmaceutical products primarily to drug wholesalers and retailers, hospitals, government agencies and managed health care providers, such as health maintenance organizations, pharmacy benefit managers and other institutions. Human health vaccines are sold primarily to physicians, wholesalers, physician distributors and government entities. The Company's professional representatives communicate the effectiveness, safety and value of the Company's pharmaceutical and vaccine products to health care professionals in private practice, group practices, hospitals and managed care organizations. The Company sells its animal health products to veterinarians, distributors and animal producers. The Company's over-the-counter, foot care and sun care products are sold through wholesale and retail drug, food chain and mass merchandiser outlets, as well as club stores and specialty channels.

Raw Materials

Raw materials and supplies, which are generally available from multiple sources, are purchased worldwide and are normally available in quantities adequate to meet the needs of the Company's business.

Patents, Trademarks and Licenses

Patent protection is considered, in the aggregate, to be of material importance in the Company's marketing of its products in the United States and in most major foreign markets. Patents may cover products *per se*, pharmaceutical formulations, processes for or intermediates useful in the manufacture of products or the uses of products. Protection for individual products extends for varying periods in accordance with the legal life of patents in the various countries. The protection afforded, which may also vary from country to country, depends upon the type of patent and its scope of coverage.

The Food and Drug Administration Modernization Act includes a Pediatric Exclusivity Provision that may provide an additional six months of market exclusivity in the United States for indications of new or currently marketed drugs if certain agreed upon pediatric studies are completed by the applicant. Current U.S. patent law provides additional patent term under Patent Term Restoration for periods when the patented product was under regulatory review by the FDA.

Patent portfolios developed for products introduced by the Company normally provide market exclusivity. The Company has the following key U.S. patent protection (including Patent Term Restoration and Pediatric Exclusivity) for major marketed products:

Product	**Year of Expiration (in the U.S.)**[(1)]
Propecia[(2)]	2013 (formulation/use)
Asmanex	2014 (use)/2018 (formulation)
Avelox[(3)]	2014
Dulera	2014 (use)/2017(formulation)/2020 (combination)
Integrilin	2014 (compound)/2015 (use/formulation)
Nasonex[(4)]	2014 (use/formulation)/2018(formulation)
Temodar[(5)]	2014
Emend	2015
Follistim AQ	2015
PegIntron	2015 (conjugates)/2020 (Mature IFN-alpha)
Invanz	2016 (compound)/2017 (composition)
Zostavax	2016 (use)
Zetia[(6)]*/Vytorin*	2017
NuvaRing	2018 (delivery system)
Noxafil	2019
RotaTeq	2019
Intron A	2020
Recombivax	2020 (method of making/vectors)
Saphris/Sycrest	2020 (use/formulation) (with pending Patent Term Restoration)
Januvia/Janumet/Juvisync/Janumet XR	2022 (compound)/2026 (salt)
Zioptan	2022 (with pending Patent Term Restoration)
Isentress	2023
Victrelis	2024 (with pending Patent Term Restoration)
Gardasil	2028

(1) *Compound patent unless otherwise noted. Certain of the products listed may be the subject of patent litigation. See Item 8. "Financial Statements and Supplementary Data," Note 11. "Contingencies and Environmental Liabilities" below.*

(2) *By agreement, a generic manufacturer entered the U.S. market in January 2013, and another has been given the right to enter in July 2013 with a generic version of* Propecia*.*

(3) *By agreement, a generic manufacturer may launch a generic version of* Avelox *in the United States in February 2014.*

(4) *By agreement, a generic manufacturer has been granted rights under Merck's* Nasonex *use patent in the United States. In addition, a recent court decision found that a proposed generic product by a generic manufacturer would not infringe on Merck's* Nasonex *formulation patent. Thus, if the generic manufacturer's application is approved by the FDA, it can enter the market in the United States with a generic version of* Nasonex*. That decision is under appeal.*

(5) *By agreement, a generic manufacturer may launch a generic version of* Temodar *in the United States in August 2013.*

(6) *By agreement, a generic manufacturer may launch a generic version of* Zetia *in the United States in December 2016.*

While the expiration of a product patent normally results in a loss of market exclusivity for the covered pharmaceutical product, commercial benefits may continue to be derived from: (i) later-granted patents on processes and intermediates related to the most economical method of manufacture of the active ingredient of such product; (ii) patents relating to the use of such product; (iii) patents relating to novel compositions and formulations; and (iv) in the United States and certain other countries, market exclusivity that may be available under relevant law. The effect of product patent expiration on pharmaceutical products also depends upon many other factors such as the nature of the market and the position of the product in it, the growth of the market, the complexities and economics of the process for manufacture of the active ingredient of the product and the requirements of new drug provisions of the Federal Food, Drug and Cosmetic Act or similar laws and regulations in other countries.

The patent that provides U.S. market exclusivity for *Avelox* expires in March 2014; however, by agreement, a generic manufacturer may launch a generic version of *Avelox* in the United States in February 2014. Also, the patent that provides market exclusivity in the United States for *Temodar* will expire in February 2014; however, by agreement, a generic manufacturer may launch a generic version of *Temodar* in the United States in August 2013. The Company anticipates that sales in the United States will decline significantly after these patent expiries.

Additions to market exclusivity are sought in the United States and other countries through all relevant laws, including laws increasing patent life. Some of the benefits of increases in patent life have been partially offset by an increase in the number of incentives for and use of generic products. Additionally, improvements in intellectual property laws are sought in the United States and other countries through reform of patent and other relevant laws and implementation of international treaties.

The Company has the following key U.S. patent protection for drug candidates under review in the United States by the FDA. Additional patent term may be provided for these pipeline candidates based on Patent Term Restoration and Pediatric Exclusivity.

Under Review	Currently Anticipated Year of Expiration (in the U.S.)(1)(2)(3)(4)
MK-0653C (ezetimibe/atorvastatin)	2017
MK-8616 (sugammadex sodium injection)	2021
MK-4305 (suvorexant)	2029

The Company also has the following key U.S. patent protection for drug candidates in Phase III development:

Phase III Drug Candidate	Currently Anticipated Year of Expiration (in the U.S.)(1)(2)(3)(4)
V212 (inactivated varicella zoster virus (“VZV”) vaccine)	2016 (method of use)
MK-8175A (NOMAC/E2)	2017 (use)
MK-8962 (corifollitropin alfa injection)	2018 (formulation)
V419 (pediatric hexavalent combination vaccine)	2020 (method of making/vectors)
MK-3814 (preladenant)	2021
MK-3641 (ragweed)	2023
MK-7243 (grass pollen)	2023
MK-0822 (odanacatib)	2024
MK-5348 (vorapaxar)	2024
MK-8109 (vintafolide)	2024
MK-0859 (anacetrapib)	2027
MK-3222 (psoriasis)	2028 (composition)
MK-3415A (actoxumab/bezlotoxumab)	2028
V503 (HPV vaccine (9 valent))	2028
MK-3102 (diabetes mellitus)	2030

(1) *Compound patent unless otherwise noted.*

(2) *Subject to any future patent term restoration of up to five years and six month pediatric market exclusivity, either or both of which may be available.*

(3) *Depending on the circumstances surrounding any final regulatory approval of the compound, there may be other listed patents or patent applications pending that could have relevance to the product as finally approved; the relevance of any such application would depend upon the claims that ultimately may be granted and the nature of the final regulatory approval of the product.*

(4) *Regulatory exclusivity tied to the protection of clinical data is complementary to patent protection and, in many cases, may provide more efficacious or longer lasting marketing exclusivity than a compound’s patent estate. In the United States, the data protection generally runs 5 years from first marketing approval of a new chemical entity, extended to 7 years for an orphan drug indication and 12 years from first marketing approval of a biological product.*

For further information with respect to the Company’s patents, see Item 1A. “Risk Factors” and Item 8. “Financial Statements and Supplementary Data,” Note 11. “Contingencies and Environmental Liabilities” below.

Worldwide, all of the Company’s important products are sold under trademarks that are considered in the aggregate to be of material importance. Trademark protection continues in some countries as long as used; in other countries, as long as registered. Registration is for fixed terms and can be renewed indefinitely.

Royalty income in 2012 on patent and know-how licenses and other rights amounted to $352 million. Merck also incurred royalty expenses amounting to $1.3 billion in 2012 under patent and know-how licenses it holds.

Research and Development

The Company's business is characterized by the introduction of new products or new uses for existing products through a strong research and development program. Approximately 13,600 people are employed in the Company's research activities. Research and development expenses were $8.2 billion in 2012, $8.5 billion in 2011, and $11.1 billion in 2010 (which included restructuring costs in all years, as well as $200 million, $587 million and $2.4 billion of in-process research and development impairment charges in 2012, 2011 and 2010, respectively). The Company maintains its ongoing commitment to research over a broad range of therapeutic areas and clinical development in support of new products.

The Company maintains a number of long-term exploratory and fundamental research programs in biology and chemistry as well as research programs directed toward product development. The Company's research and development model is designed to increase productivity and improve the probability of success by prioritizing the Company's research and development resources on disease areas of unmet medical needs, scientific opportunity and commercial opportunity. Merck is managing its research and development portfolio across diverse approaches to discovery and development by balancing investments appropriately on novel, innovative targets with the potential to have a major impact on human health, on developing best-in-class approaches, and on delivering maximum value of its approved medicines and vaccines through new indications and new formulations. Another important component of the Company's science-based diversification is based on expanding the Company's portfolio of modalities to include not only small molecules and vaccines, but also biologics (peptides, small proteins, antibodies) and RNAi. Further, Merck has moved to diversify its portfolio through biosimilars, which have the potential to harness the market opportunity presented by biological medicine patent expiries by delivering high quality follow-on biologic products to enhance access for patients worldwide. The Company supplements its internal research with a licensing and external alliance strategy focused on the entire spectrum of collaborations from early research to late-stage compounds, as well as new technologies.

The Company's clinical pipeline includes candidates in multiple disease areas, including atherosclerosis, cancer, cardiovascular diseases, diabetes, infectious diseases, inflammatory/autoimmune diseases, insomnia, neurodegenerative diseases, osteoporosis, respiratory diseases and women's health.

In the development of human health products, industry practice and government regulations in the United States and most foreign countries provide for the determination of effectiveness and safety of new chemical compounds through preclinical tests and controlled clinical evaluation. Before a new drug or vaccine may be marketed in the United States, recorded data on preclinical and clinical experience are included in the NDA for a drug or the BLA for a vaccine or biologic submitted to the FDA for the required approval.

Once the Company's scientists discover a new small molecule compound or biologics molecule that they believe has promise to treat a medical condition, the Company commences preclinical testing with that compound. Preclinical testing includes laboratory testing and animal safety studies to gather data on chemistry, pharmacology, immunogenicity and toxicology. Pending acceptable preclinical data, the Company will initiate clinical testing in accordance with established regulatory requirements. The clinical testing begins with Phase I studies, which are designed to assess safety, tolerability, pharmacokinetics, and preliminary pharmacodynamic activity of the compound in humans. If favorable, additional, larger Phase II studies are initiated to determine the efficacy of the compound in the affected population, define appropriate dosing for the compound, as well as identify any adverse effects that could limit the compound's usefulness. In some situations, the clinical program incorporates adaptive design methodology to use accumulating data to decide how to modify aspects of the ongoing clinical study as it continues, without undermining the validity and integrity of the trial. One type of adaptive clinical trial is an adaptive Phase IIa/IIb trial design, a two-stage trial design consisting of a Phase IIa proof-of-concept stage and a Phase IIb dose-optimization finding stage. If data from the Phase II trials are satisfactory, the Company commences large-scale Phase III trials to confirm the compound's efficacy and safety. Upon completion of those trials, if satisfactory, the Company submits regulatory filings with the appropriate regulatory agencies around the world to have the product candidate approved for marketing. There can be no assurance that a compound that is the result of any particular program will obtain the regulatory approvals necessary for it to be marketed.

Vaccine development follows the same general pathway as for drugs. Preclinical testing focuses on the vaccine's safety and ability to elicit a protective immune response (immunogenicity). Pre-marketing vaccine clinical trials are typically done in three phases. Initial Phase I clinical studies are conducted in normal subjects to evaluate the safety, tolerability and immunogenicity of the vaccine candidate. Phase II studies are dose-ranging studies. Finally, Phase III trials provide the necessary data on effectiveness and safety. If successful, the Company submits regulatory filings with the appropriate regulatory agencies. Also during this stage, the proposed manufacturing facility undergoes a pre-approval inspection during which production of the vaccine as it is in progress is examined in detail.

In the United States, the FDA review process begins once a complete NDA or BLA is submitted, received and accepted for review by the agency. Within 60 days after receipt, the FDA determines if the application is sufficiently complete to permit a substantive review. The FDA also assesses, at that time, whether the application will be granted a priority review or standard review. Pursuant to the Prescription Drug User Fee Act V, the FDA review period target for NDAs or original BLAs is either six months, for priority review, or ten months, for a standard review, from the time the application is deemed sufficiently complete. Once the review timelines are determined, the FDA will generally act upon the application within those timelines, unless a major amendment has been submitted (either at the Company's own initiative or the FDA's request) to the pending application. If this occurs, the FDA may extend the review period to allow for review of the new information, but by no more than three months. Extensions to the review period are communicated to the Company. The FDA can act on an application either by issuing an approval letter, or by issuing a Complete Response Letter stating that the application will not be approved in its present form and describing all deficiencies that the FDA has identified. Should the Company wish to pursue an application after receiving a Complete Response Letter, it can resubmit the application with information that addresses the questions or issues identified by the FDA in order to support approval. Resubmissions are subject to review period targets, which vary depending on the underlying submission type and the content of the resubmission.

The primary method the Company uses to obtain marketing authorization of pharmaceutical products in the EU is through the "centralized procedure." This procedure is compulsory for certain pharmaceutical products, in particular those using biotechnological processes, and is also available for certain new chemical compounds and products. A company seeking to market an innovative pharmaceutical product through the centralized procedure must file a complete set of safety data and efficacy data as part of a Marketing Authorization Application ("MAA") with the European Medicines Agency ("EMA"). After the EMA evaluates the MAA, it provides a recommendation to the EC and the EC then approves or denies the MAA. It is also possible for new chemical products to obtain marketing authorization in the EU through a "mutual recognition procedure," in which an application is made to a single member state, and if the member state approves the pharmaceutical product under a national procedure, then the applicant may submit that approval to the mutual recognition procedure of some or all other member states.

Research and Development Update

The Company currently has four candidates under regulatory review in the United States and internationally.

MK-4305, suvorexant, an investigational insomnia medicine in a new class of medicines called orexin receptor antagonists for use in patients with difficulty falling or staying asleep, is under review by the FDA. Suvorexant will be evaluated by the Controlled Substance Staff of the FDA during NDA review. If approved by the FDA, suvorexant will become available after a schedule assessment and determination has been completed by the U.S. Drug Enforcement Administration, which routinely occurs after FDA approval. The Company has also submitted a new drug application for suvorexant to the health authorities in Japan and is continuing with plans to seek approval for suvorexant in other countries around the world.

MK-8616, sugammadex sodium injection, is an investigational agent for the reversal of neuromuscular blockade induced by rocuronium or vecuronium (neuromuscular blocking agents) under review by the FDA. Neuromuscular blockade is used in anesthesiology to induce muscle relaxation during surgery. If approved, MK-8616 would be the first in a new class of medicines in the United States known as selective relaxant binding agents to be used in the surgical setting. In 2008, the FDA did not approve the original NDA for sugammadex sodium injection, requesting additional data related to hypersensitivity (allergic) reactions and coagulation (bleeding) events. Merck submitted these requested data within the NDA resubmission, which the FDA deemed complete for review. The Company expects the FDA's review to be completed in the first half of 2013. Sugammadex sodium injection is approved and has been launched in many countries outside of the United States where it is marketed as *Bridion*.

MK-8109, vintafolide, is an investigational cancer candidate under review by the EMA. As part of an exclusive license agreement with Endocyte, Merck is responsible for the development and worldwide commercialization of vintafolide in oncology. The EMA accepted the MAA filings for vintafolide and Endocyte's investigational companion diagnostic imaging agent, etarfolatide, for the targeted treatment of patients with folate-receptor positive platinum-resistant ovarian cancer in combination with pegylated liposomal doxorubicin. Both vintafolide and etarfolatide have been granted orphan drug status by the EC. Vintafolide is in Phase III development in the United States.

MK-0653C is an investigational combination of ezetimibe and atorvastatin for the treatment of primary or mixed hyperlipidemia under review by the FDA. An updated NDA for MK-0653C was deemed complete for review by the FDA after Merck submitted additional data in response to the FDA's Complete Response Letter issued in 2012. Merck expects the FDA's review to be completed in the first half of 2013. Merck is continuing to move forward with planned filings for the ezetimibe and atorvastatin combination tablet in additional countries around the world.

In addition to the candidates under regulatory review, the Company has 16 drug candidates in Phase III development targeting a broad range of diseases. The Company anticipates filing an NDA or a BLA, as applicable, with the FDA with respect to several of these candidates in 2013.

V503 is a nine-valent HPV vaccine in development to help protect against certain HPV-related diseases. V503 incorporates antigens against five additional cancer-causing HPV types as compared with *Gardasil*. As previously disclosed, the 14,000-patient Phase III event-driven clinical study of V503 is ongoing. Merck anticipates filing a BLA for V503 with the FDA in 2013.

MK-8962, corifollitropin alpha injection, which is being marketed as *Elonva* in the EU, is an investigational fertility treatment for controlled ovarian stimulation in women participating in *in vitro* fertilization or intracytoplasmic sperm injection currently in Phase III development in the United States. Merck continues to anticipate filing an NDA for MK-8962 with the FDA in 2013.

MK-5348, vorapaxar, is a thrombin receptor antagonist being developed for the prevention of thrombosis, or clot formation, and the reduction of cardiovascular events. Vorapaxar has been evaluated in two major clinical outcomes studies in different patient groups: TRACER (Thrombin Receptor Antagonist for Clinical Event Reduction in Acute Coronary Syndrome), a clinical outcomes trial in patients with acute coronary syndrome, and TRA-2P (Thrombin Receptor Antagonist in Secondary Prevention of atherothrombotic ischemic events), a secondary prevention study in patients with a previous heart attack or ischemic stroke, or with documented peripheral vascular disease. In March 2012, results from the TRA-2P study of vorapaxar were presented at the American College of Cardiology Annual Scientific Session and published concurrently in the online edition of the New England Journal of Medicine. In the study, the addition of vorapaxar to standard of care (e.g. aspirin or thienopyridine or both) resulted in a significantly greater reduction in the risk of the composite of cardiovascular death, heart attack, stroke or urgent coronary revascularization. There was also a significant increase in bleeding, including intracranial hemorrhage, among patients taking vorapaxar in addition to standard of care, although the risk of intracranial hemorrhage was lower in patients without a history of stroke. In November 2011, researchers presented results from the TRACER outcomes study at the American Heart Association Scientific Sessions, and the results have been published. TRACER did not achieve its primary endpoint. In January 2011, Merck and the external study investigators announced that the combined Data Safety Monitoring Board ("DSMB") for the two clinical trials had reviewed the available safety and efficacy data, and recommended that patients in the TRACER trial discontinue study drug and investigators close out the study. Following a review of the clinical trial data and discussions with external experts, Merck plans to file applications for vorapaxar in the United States and EU in 2013 seeking an indication for the prevention of cardiovascular events in patients with a history of heart attack and no history of transient ischemic attack or stroke.

MK-7243 is an investigational allergy immunotherapy sublingual tablet ("AIT") in Phase III development for grass pollen allergy for which the Company has North American rights. AIT is a dissolvable oral tablet that is designed to prevent allergy symptoms by inducing a protective immune response against allergies, thereby treating the underlying cause of the disease. Merck is investigating AIT for the treatment of grass pollen allergic rhinoconjunctivitis in both children and adults. The Company has submitted a BLA for MK-7243 with the FDA.

MK-3641, an AIT for ragweed allergy, is also in Phase III development for the North American market. The Company anticipates filing a BLA for MK-3641 with the FDA in 2013.

MK-8175A, NOMAC/E2, which is being marketed as *Zoely* in the EU, is an investigational oral contraceptive for use by women to prevent pregnancy. NOMAC/E2 is a combined oral contraceptive tablet containing a unique monophasic combination of two hormones: nomegestrol acetate, a highly selective progesterone-derived progestin, and 17-beta estradiol, an estrogen that is similar to the one naturally present in a women's body. In November 2011, Merck received a Complete Response Letter from the FDA for NOMAC/E2. The Company is conducting an additional clinical study requested by the FDA and plans to update the application in the future.

MK-0822, odanacatib, is an oral, once-weekly investigational treatment for osteoporosis in post-menopausal women. Osteoporosis is a disease that reduces bone density and strength and results in an increased risk of bone fractures. Odanacatib is a cathepsin K inhibitor that selectively inhibits the cathepsin K enzyme. Cathepsin K is known to play a central role in the function of osteoclasts, which are cells that break down existing bone tissue, particularly the protein components of bone. Inhibition of cathepsin K is a novel approach to the treatment of osteoporosis. In July 2012, Merck announced an update on the Phase III trial assessing fracture risk reduction with odanacatib. The independent Data Monitoring Committee (the "DMC") for the study completed its first planned interim analysis for efficacy and recommended that the study be closed early due to robust efficacy and a favorable benefit-risk profile. The DMC noted that safety issues remain in certain selected areas and made recommendations with respect to following up on them. On February 1, 2013, Merck announced that it had recently received and was reviewing safety and efficacy data from the Phase III trial. As a result of its review of this data, the Company concluded that review of additional data from the previously planned, ongoing extension study was warranted and that filing an application for approval with the FDA should be delayed. As previously announced, the Company is conducting a blinded extension of the trial in approximately 8,200 women, which will provide additional safety and efficacy data. Merck now anticipates that it will file applications for approval of odanacatib in 2014 with additional data from the extension trial. The Company continues to believe that odanacatib will have the potential to address unmet medical needs in patients with osteoporosis.

MK-3814, preladenant, is a selective adenosine 2a receptor antagonist in Phase III development for treatment of Parkinson's disease. The Company anticipates filing an NDA for MK-3814 with the FDA in 2014.

V212 is an inactivated VZV vaccine in development for the prevention of herpes zoster. The Company is enrolling two Phase III trials, one in autologous hematopoietic cell transplant patients and the other in patients with solid tumor malignancies undergoing chemotherapy and hematological malignancies. The Company anticipates filing a BLA first with the autologous hematopoietic cell transplant data in 2014 and filing for the second indication in cancer patients at a later date.

V419 is an investigational hexavalent pediatric combination vaccine, which contains components of current vaccines, designed to help protect against six potentially serious diseases: diphtheria, tetanus, whooping cough (*Bordetella pertussis*), polio (poliovirus types 1, 2, and 3), invasive disease caused by *Haemophilus influenzae* type b, and hepatitis B that is being developed in collaboration with Sanofi-Pasteur. The Company anticipates filing a BLA for V419 with the FDA in 2014.

MK-7009, vaniprevir, is an investigational, oral twice-daily protease inhibitor for the treatment of chronic hepatitis C virus for development in Japan only. The Company anticipates filing a new drug application for MK-7009 in Japan in 2014.

MK-3102 is an investigational once-weekly DPP-4 inhibitor in development for the treatment of type 2 diabetes. The Company anticipates filing an NDA for MK-3102 with the FDA beyond 2014.

MK-3222 is an anti-interleukin-23 monoclonal antibody candidate being investigated for the treatment of psoriasis. The Company anticipates filing a BLA for MK-3222 with the FDA beyond 2014.

MK-3415A, actoxumab/bezlotoxumab, an investigational candidate for the treatment of *Clostridium difficile* infection, is a combination of two monoclonal antibodies used to treat patients with a single infusion. The Company now anticipates filing a BLA for MK-3415A with the FDA in 2015.

MK-0859, anacetrapib, is an investigational inhibitor of the cholesteryl ester transfer protein ("CETP") that is being investigated in lipid management to raise HDL-C and reduce LDL-C. Based on the results from the Phase III DEFINE (Determining the EFficacy and Tolerability of CETP INhibition with AnacEtrapib) safety study of 1,623 patients with coronary heart disease or coronary heart disease risk equivalents, the Company initiated a large, event-driven cardiovascular clinical outcomes trial REVEAL (Randomized EValuation of the Effects of Anacetrapib Through Lipid-modification) involving patients with preexisting vascular disease that is predicted to be completed in 2017. The Company continues to anticipate filing an NDA for anacetrapib with the FDA beyond 2015.

MK-8931 is Merck's novel investigational oral ß-amyloid precursor protein site-cleaving enzyme (BACE) inhibitor for the treatment of Alzheimer's disease. In December 2012, Merck announced the initiation of a Phase II/III clinical trial (EPOCH) designed to evaluate the safety and efficacy of MK-8931 versus placebo in patients with mild-to-moderate Alzheimer's disease.

MK-8669, ridaforolimus, is an investigational oral mTOR (mammalian target of rapamycin) inhibitor under development for cancer indications. In June 2012, Merck announced that the FDA issued a Complete Response Letter regarding the NDA for ridaforolimus as a treatment for metastatic soft tissue or bone sarcoma. The Complete Response Letter states that the FDA cannot approve the application in its present form, and that additional clinical trial(s) would need to be conducted to further assess safety and efficacy. In November 2012, Merck formally notified the EMA of its decision to withdraw the MAA for ridaforolimus that was accepted by the EMA in 2011. The Company no longer plans to pursue the sarcoma indication in the United States or the EU, but will continue to support patients enrolled in ongoing clinical trials. Merck remains committed to pursuing ridaforolimus in other cancer indications. As part of an exclusive license agreement with ARIAD Pharmaceuticals, Inc. ("ARIAD"), Merck is responsible for the development and worldwide commercialization of ridaforolimus in oncology.

In December 2012, Merck announced the HPS2-THRIVE study of MK-0524A, *Tredaptive*, did not meet its primary endpoint. In the study, adding the combination of extended-release niacin and laropiprant to statin therapy did not significantly further reduce the risk of the combination of coronary deaths, non-fatal heart attacks, strokes or revascularizations compared to statin therapy. In addition, there was a statistically significant increase in the incidence of some types of non-fatal serious adverse events in the group that received extended-release niacin/laropiprant compared to statin therapy. Merck does not plan to seek regulatory approval for the medicine in the United States. In January 2013, based on the understanding of the preliminary data from the HPS2-THRIVE study and in consultation with regulatory authorities, Merck began taking steps to suspend the availability of *Tredaptive*, which is approved for use in certain countries outside of the United States. The clinical development program for MK-0524B, a combination product of extended-release niacin with laropiprant and simvastatin, had previously been discontinued.

In 2012, Merck announced that it will return the global marketing and development rights for both the intravenous and oral formulations for vernakalant, a treatment for atrial fibrillation, to Cardiome Pharma Corp. for business reasons. Merck also decided in 2012 to discontinue the clinical development program for MK-0431E, a combination product of sitagliptin and atorvastatin for the treatment of type 2 diabetes, for business reasons.

The chart below reflects the Company's research pipeline as of February 22, 2013. Candidates shown in Phase III include specific products and the date such candidate entered into Phase III development. Candidates shown in Phase II include the most advanced compound with a specific mechanism or, if listed compounds have the same mechanism, they are each currently intended for commercialization in a given therapeutic area. Small molecules and biologics are given MK-number designations and vaccine candidates are given V-number designations. Candidates in Phase I, additional indications in the same therapeutic area and additional claims, line extensions or formulations for in-line products are not shown.

Phase II	Phase III (Phase III entry date)	Under Review
Allergy MK-8237, Immunotherapy[1] **Alzheimer's Disease** MK-8931[2] **Asthma** MK-1029 **Bacterial Infection** MK-7655 **Cancer** MK-0646 (dalotuzumab) MK-1775 MK-2206 MK-7965 (dinaciclib)[2] MK-8669 (ridaforolimus) **CMV Prophylaxis in Transplant Patients** MK-8228 (letermovir) **Contraception, Medicated IUS** MK-8342 **Contraception, Next Generation Ring** MK-8175A MK-8342B **Hepatitis C** MK-5172 MK-8742 **HIV** MK-1439 **Insomnia** MK-6096 **Melanoma** MK-3475 **Migraine** MK-1602 **Overactive Bladder** MK-4618 **Pneumoconjugate Vaccine** V114 **Rheumatoid Arthritis** MK-8457	**Allergy** MK-7243, Grass pollen (March 2008)[1][3] MK-3641, Ragweed (September 2009)[1] **Atherosclerosis** MK-0859 (anacetrapib) (May 2008) ***Clostridium difficile* Infection** MK-3415A (actoxumab/bezlotoxumab) (November 2011) **Contraception** MK-8175A (NOMAC/E2) (U.S.) (June 2006)[4] **Diabetes Mellitus** MK-3102 (September 2012) **Fertility** MK-8962 (corifollitropin alfa injection) (U.S.) (July 2006) **Hepatitis C** MK-7009 (vaniprevir) (June 2011)[5] **Herpes Zoster** V212 (inactivated VZV vaccine) (December 2010) **HPV-Related Cancers** V503 (HPV vaccine (9 valent)) (September 2008) **Osteoporosis** MK-0822 (odanacatib) (September 2007) **Parkinson's Disease** MK-3814 (preladenant) (July 2010) **Pediatric Hexavalent Combination Vaccine** V419 (April 2011) **Platinum-Resistant Ovarian Cancer** MK-8109 (vintafolide) (U.S.) (April 2011) **Psoriasis** MK-3222 (December 2012) **Thrombosis** MK-5348 (vorapaxar) (September 2007)	**Atherosclerosis** MK-0653C (ezetimibe/atorvastatin) (U.S.) **Insomnia** MK-4305 (suvorexant) (U.S.) **Neuromuscular Blockade Reversal** MK-8616 (sugammadex sodium injection) (U.S.) **Platinum-Resistant Ovarian Cancer** MK-8109 (vintafolide) (EU) **Footnotes:** (1) North American rights only. (2) Phase II/III adaptive design. (3) The Company has submitted a BLA for MK-7243 and now awaits acceptance for review by the FDA. (4) In November 2011, Merck received a Complete Response Letter from the FDA for NOMAC/E2 (MK-8175A). The Company is conducting an additional clinical study requested by the FDA and plans to update the application in the future. (5) For development in Japan only.

Employees

As of December 31, 2012, the Company had approximately 83,000 employees worldwide, with approximately 32,500 employed in the United States, including Puerto Rico. Approximately 31% of worldwide employees of the Company are represented by various collective bargaining groups.

In 2010, the Company commenced actions under a global restructuring program (the "Merger Restructuring Program") in conjunction with the integration of the legacy Merck and legacy Schering-Plough businesses designed to optimize the cost structure of the combined company. These initial actions, which are expected to result in workforce reductions of approximately 17%, primarily reflect the elimination of positions in sales, administrative and headquarters organizations, as well as from the sale or closure of certain manufacturing and research and development sites and the consolidation of office facilities. In July 2011, the Company initiated further actions under the Merger Restructuring Program through which the Company expects to reduce its workforce measured at the time of the Merger by an additional 12% to 13% across the Company worldwide. A majority of the workforce reductions associated with these additional actions relate to manufacturing (including

Animal Health), administrative and headquarters organizations. Since inception of the Merger Restructuring Program through December 31, 2012, Merck has eliminated approximately 22,400 positions comprised of employee separations, as well as the elimination of contractors and vacant positions.

In October 2008, Merck announced a global restructuring program (the "2008 Restructuring Program") to reduce its cost structure, increase efficiency, and enhance competitiveness. As part of the 2008 Restructuring Program, the Company expects to eliminate approximately 7,200 positions — 6,800 active employees and 400 vacancies — across the Company worldwide. Since inception of the 2008 Restructuring Program through December 31, 2012, Merck has eliminated approximately 6,400 positions comprised of employee separations and the elimination of contractors and vacant positions.

Environmental Matters

The Company believes that there are no compliance issues associated with applicable environmental laws and regulations that would have a material adverse effect on the Company. The Company is also remediating environmental contamination resulting from past industrial activity at certain of its sites. Expenditures for remediation and environmental liabilities were $14 million in 2012, $25 million in 2011 and $16 million in 2010, and are estimated at $84 million in the aggregate for the years 2013 through 2017. These amounts do not consider potential recoveries from other parties. The Company has taken an active role in identifying and providing for these costs and, in management's opinion, the liabilities for all environmental matters, which are probable and reasonably estimable, have been accrued and totaled $145 million at December 31, 2012. Although it is not possible to predict with certainty the outcome of these environmental matters, or the ultimate costs of remediation, management does not believe that any reasonably possible expenditures that may be incurred in excess of the liabilities accrued should exceed $112 million in the aggregate. Management also does not believe that these expenditures should have a material adverse effect on the Company's financial position, results of operations, liquidity or capital resources for any year.

Merck believes that climate change could present risks to its business. Some of the potential impacts of climate change to its business include increased operating costs due to additional regulatory requirements, physical risks to the Company's facilities, water limitations and disruptions to its supply chain. These potential risks are integrated into the Company's business planning including investment in reducing energy, water use and greenhouse gas emissions. The Company does not believe these risks are material to its business at this time.

Geographic Area Information

The Company's operations outside the United States are conducted primarily through subsidiaries. Sales worldwide by subsidiaries outside the United States were 57% of sales in 2012, 57% of sales in 2011 and 56% of sales in 2010.

The Company's worldwide business is subject to risks of currency fluctuations, governmental actions and other governmental proceedings abroad. The Company does not regard these risks as a deterrent to further expansion of its operations abroad. However, the Company closely reviews its methods of operations and adopts strategies responsive to changing economic and political conditions.

Merck has expanded its operations in countries located in Latin America, the Middle East, Africa, Eastern Europe and Asia Pacific. Business in these developing areas, while sometimes less stable, offers important opportunities for growth over time.

Financial information about geographic areas of the Company's business is discussed in Item 8. "Financial Statements and Supplementary Data" below.

Available Information

The Company's Internet website address is *www.merck.com*. The Company will make available, free of charge at the "Investors" portion of its website, its Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and all amendments to those reports filed or furnished pursuant to Section 13(a) or

15(d) of the Securities Exchange Act of 1934, as amended, as soon as reasonably practicable after such reports are electronically filed with, or furnished to, the Securities and Exchange Commission ("SEC").

The Company's corporate governance guidelines and the charters of the Board of Directors' four standing committees are available on the Company's website at *www.merck.com/about/leadership* and all such information is available in print to any stockholder who requests it from the Company.

Item 1A. Risk Factors.

Investors should carefully consider all of the information set forth in this Form 10-K, including the following risk factors, before deciding to invest in any of the Company's securities. The risks below are not the only ones the Company faces. Additional risks not currently known to the Company or that the Company presently deems immaterial may also impair its business operations. The Company's business, financial condition, results of operations or prospects could be materially adversely affected by any of these risks. This Form 10-K also contains forward-looking statements that involve risks and uncertainties. The Company's results could materially differ from those anticipated in these forward-looking statements as a result of certain factors, including the risks it faces described below and elsewhere. See "Cautionary Factors that May Affect Future Results" below.

***Singulair* and *Maxalt* lost market exclusivity in the United States in 2012, and the Company is experiencing a significant decline in sales of those products. In addition, *Singulair* and *Maxalt* will each lose market exclusivity in the EU in 2013 and the Company expects a significant decline in sales of those products in these markets.**

The Company depends upon patents to provide it with exclusive marketing rights for its products for some period of time. As product patents for several of the Company's products have recently expired in the United States and in other countries, the Company faces strong competition from lower priced generic drugs. Loss of patent protection for one of the Company's products typically leads to a rapid loss of sales for that product, as lower priced generic versions of that drug become available. In the case of products that contribute significantly to the Company's sales, the loss of patent protection can have a material adverse effect on the Company's business, cash flow, results of operations, financial position and prospects. The patent that provided U.S. market exclusivity for *Singulair,* which in 2012 was the Company's second largest selling product globally, and which had U.S. sales of $2.2 billion, expired in August 2012. Accordingly, the Company experienced a significant and rapid decline in U.S. Singulair sales, which declined 97% in the fourth quarter of 2012 to $25 million as compared to the fourth quarter of 2011. The patent that provided market exclusivity for *Singulair* expired in a number of major European markets in February 2013 and the Company expects a significant and rapid decline in sales of *Singulair* in those markets. The patent that provided U.S. market exclusivity for *Maxalt* expired in December 2012. Also, the patent that provides market exclusivity for *Maxalt* will expire in a number of major European markets in August 2013. The Company anticipates that sales in the United States, which were approximately $491 million in 2012, and in these European markets will decline significantly as a result of these patent expiries. Also, two additional Company products, *Temodar* and *Propecia*, will lose market exclusivity in the United States in 2013 and the Company anticipates that sales will decline significantly.

A chart listing the U.S. patent protection for the Company's major marketed products is set forth above in Item 1. "Business — Patents, Trademarks and Licenses."

The Company is dependent on its patent rights, and if its patent rights are invalidated or circumvented, its business would be adversely affected.

Patent protection is considered, in the aggregate, to be of material importance in the Company's marketing of human health products in the United States and in most major foreign markets. Patents covering products that it has introduced normally provide market exclusivity, which is important for the successful marketing and sale of its products. The Company seeks patents covering each of its products in each of the markets where it intends to sell the products and where meaningful patent protection is available.

Even if the Company succeeds in obtaining patents covering its products, third parties or government authorities may challenge or seek to invalidate or circumvent its patents and patent applications. It is important for the Company's business to defend successfully the patent rights that provide market exclusivity for its products. The Company is often involved in patent disputes relating to challenges to its patents or infringement and similar claims against the Company. The Company aggressively defends its important patents both within and outside the United States, including by filing claims of infringement against other parties. See Item 8. "Financial Statements and Supplementary Data," Note 11. "Contingencies and Environmental Liabilities" below. In particular, manufacturers of generic pharmaceutical products from time to time file Abbreviated New Drug Applications with the FDA seeking to market generic forms of the Company's products prior to the expiration of relevant patents owned by the Company. The Company normally responds by vigorously defending its patent, including by filing lawsuits alleging patent infringement. As discussed above, in 2012, a court decision found that a proposed generic product by a generic manufacturer would not infringe on the Company's *Nasonex* formulation patent. If the generic manufacturer's application is approved by the FDA, it can enter the market in the United States with a generic version of *Nasonex* which would adversely affect sales of *Nasonex*. Patent litigation and other challenges to the Company's patents are costly and unpredictable and may deprive the Company of market exclusivity for a patented product or, in some cases, third-party patents may prevent the Company from marketing and selling a product in a particular geographic area.

Additionally, certain foreign governments have indicated that compulsory licenses to patents may be granted in the case of national emergencies or in other circumstances, which could diminish or eliminate sales and profits from those regions and negatively affect the Company's results of operations. Further, recent court decisions relating to other companies' U.S. patents, potential U.S. legislation relating to patent reform, as well as regulatory initiatives may result in further erosion of intellectual property protection.

If one or more important products lose patent protection in profitable markets, sales of those products are likely to decline significantly as a result of generic versions of those products becoming available and, in the case of certain products, such a loss could result in a material non-cash impairment charge. The Company's results of operations may be adversely affected by the lost sales unless and until the Company has successfully launched commercially successful replacement products.

Key Company products generate a significant amount of the Company's profits and cash flows, and any events that adversely affect the markets for its leading products could have a material and negative impact on results of operations and cash flows.

The Company's ability to generate profits and operating cash flow depends largely upon the continued profitability of the Company's key products, such as *Januvia*, *Remicade*, *Zetia, Vytorin, Janumet, Isentress, Nasonex* and *Gardasil*. As a result of the Company's dependence on key products, any event that adversely affects any of these products or the markets for any of these products could have a significant impact on results of operations and cash flows. These events could include loss of patent protection, increased costs associated with manufacturing, generic or over-the-counter availability of the Company's product or a competitive product, the discovery of previously unknown side effects, increased competition from the introduction of new, more effective treatments and discontinuation or removal from the market of the product for any reason. If any of these events had a material adverse effect on the sales of certain products, such an event could result in a material non-cash impairment charge.

The Company's research and development efforts may not succeed in developing commercially successful products and the Company may not be able to acquire commercially successful products in other ways; in consequence, the Company may not be able to replace sales of successful products that have lost patent protection.

Like other major pharmaceutical companies, in order to remain competitive, the Company must continue to launch new products each year. Expected declines in sales of products, such as *Singulair* and *Maxalt,* after the loss of market exclusivity mean that the Company's future success is dependent on its pipeline of new products, including new products which it may develop through joint ventures and products which it is able to obtain through license or acquisition. To accomplish this, the Company commits substantial effort, funds and other resources to research and development, both through its own dedicated resources and through various collaborations with third parties. There is a high rate of failure inherent in the research to develop new drugs to treat diseases. As a result, there is a high risk that funds invested by the Company in research programs will not generate financial returns.

This risk profile is compounded by the fact that this research has a long investment cycle. To bring a pharmaceutical compound from the discovery phase to market may take a decade or more and failure can occur at any point in the process, including later in the process after significant funds have been invested.

For a description of the research and development process, see Item 1. "Business — Research and Development" above. Each phase of testing is highly regulated and during each phase there is a substantial risk that the Company will encounter serious obstacles or will not achieve its goals, therefore, the Company may abandon a product in which it has invested substantial amounts of time and resources. Some of the risks encountered in the research and development process include the following: pre-clinical testing of a new compound may yield disappointing results; clinical trials of a new drug may not be successful; a new drug may not be effective or may have harmful side effects; a new drug may not be approved by the FDA for its intended use; it may not be possible to obtain a patent for a new drug; payers may refuse to cover or reimburse the new product; or sales of a new product may be disappointing.

The Company cannot state with certainty when or whether any of its products now under development will be approved or launched; whether it will be able to develop, license or otherwise acquire compounds, product candidates or products; or whether any products, once launched, will be commercially successful. The Company must maintain a continuous flow of successful new products and successful new indications or brand extensions for existing products sufficient both to cover its substantial research and development costs and to replace sales that are lost as profitable products, such as *Singulair* and *Maxalt* in 2012 and *Temodar* and *Propecia* in 2013, lose market exclusivity or are displaced by competing products or therapies. Failure to do so in the short term or long term would have a material adverse effect on the Company's business, results of operations, cash flow, financial position and prospects.

The Company's success is dependent on the successful development and marketing of new products, which are subject to substantial risks.

Products that appear promising in development may fail to reach the market or fail to succeed for numerous reasons, including the following:

- findings of ineffectiveness, superior safety or efficacy of competing products, or harmful side effects in clinical or pre-clinical testing;
- failure to receive the necessary regulatory approvals, including delays in the approval of new products and new indications, and increasing uncertainties about the time required to obtain regulatory approvals and the benefit/risk standards applied by regulatory agencies in determining whether to grant approvals;
- failure in certain markets to obtain reimbursement commensurate with the level of innovation and clinical benefit presented by the product;
- lack of economic feasibility due to manufacturing costs or other factors; and
- preclusion from commercialization by the proprietary rights of others.

In the future, if certain pipeline programs are cancelled or if the Company believes that their commercial prospects have been reduced, the Company may recognize material non-cash impairment charges for those programs that were measured at fair value and capitalized in connection with mergers and acquisitions.

The Company's products, including products in development, can not be marketed unless the Company obtains and maintains regulatory approval.

The Company's activities, including research, preclinical testing, clinical trials and manufacturing and marketing its products, are subject to extensive regulation by numerous federal, state and local governmental authorities in the United States, including the FDA, and by foreign regulatory authorities, including in the EU. In the United States, the FDA is of particular importance to the Company, as it administers requirements covering the testing, approval, safety, effectiveness, manufacturing, labeling and marketing of prescription pharmaceuticals. In many cases, the FDA requirements have increased the amount of time and money necessary to develop new products and bring them to market in the United States. Regulation outside the United States also is primarily focused on drug safety and effectiveness and, in many cases, cost reduction. The FDA and foreign regulatory authorities have substantial discretion to require additional testing, to delay or withhold registration and marketing approval and to otherwise preclude distribution and sale of a product.

Even if the Company is successful in developing new products, it will not be able to market any of those products unless and until it has obtained all required regulatory approvals in each jurisdiction where it proposes to market the new products. Once obtained, the Company must maintain approval as long as it plans to market its new products in each jurisdiction where approval is required. The Company's failure to obtain approval, significant delays in the approval process, or its failure to maintain approval in any jurisdiction will prevent it from selling the new products in that jurisdiction until approval is obtained, if ever. The Company would not be able to realize revenues for those new products in any jurisdiction where it does not have approval.

Developments following regulatory approval may adversely affect sales of the Company's products.

Even after a product reaches market, certain developments following regulatory approval, including results in post-marketing Phase IV trials or other studies, may decrease demand for the Company's products, including the following:

- the re-review of products that are already marketed;
- new scientific information and evolution of scientific theories;
- the recall or loss of marketing approval of products that are already marketed;
- changing government standards or public expectations regarding safety, efficacy or labeling changes; and
- greater scrutiny in advertising and promotion.

In the past several years, clinical trials and post-marketing surveillance of certain marketed drugs of the Company and of competitors within the industry have raised concerns that have led to recalls, withdrawals or adverse labeling of marketed products. Clinical trials and post-marketing surveillance of certain marketed drugs also have raised concerns among some prescribers and patients relating to the safety or efficacy of pharmaceutical products in general that have negatively affected the sales of such products. In addition, increased scrutiny of the outcomes of clinical trials has led to increased volatility in market reaction. Further, these matters often attract litigation and, even where the basis for the litigation is groundless, considerable resources may be needed to respond.

In addition, following the wake of product withdrawals and other significant safety issues, health authorities such as the FDA, the EMA and Japan's Pharmaceutical and Medical Device Agency have increased their focus on safety when assessing the benefit/risk balance of drugs. Some health authorities appear to have become more cautious when making decisions about approvability of new products or indications and are re-reviewing select products that are already marketed, adding further to the uncertainties in the regulatory processes. There is also greater regulatory scrutiny, especially in the United States, on advertising and promotion and, in particular, direct-to-consumer advertising.

If previously unknown side effects are discovered or if there is an increase in negative publicity regarding known side effects of any of the Company's products, it could significantly reduce demand for the product or require the Company to take actions that could negatively affect sales, including removing the product from the market, restricting its distribution or applying for labeling changes. Further, in the current environment in which all pharmaceutical companies operate, the Company is at risk for product liability and consumer protection claims and civil and criminal governmental actions related to its products, research and/or marketing activities.

The Company faces intense competition from lower cost-generic products.

In general, the Company faces increasing competition from lower-cost generic products. The patent rights that protect its products are of varying strengths and durations. In addition, in some countries, patent protection is significantly weaker than in the United States or in the EU. In the United States and the EU, political pressure to reduce spending on prescription drugs has led to legislation and other measures which encourages the use of generic products. Although it is the Company's policy to actively protect its patent rights, generic challenges to the Company's products can arise at any time, and the Company's patents may not prevent the emergence of generic competition for its products.

Loss of patent protection for a product typically is followed promptly by generic substitutes, reducing the Company's sales of that product. Availability of generic substitutes for the Company's drugs may adversely affect its results of operations and cash flow. In addition, proposals emerge from time to time in the United States and other countries for legislation to further encourage the early and rapid approval of generic drugs. Any such proposal that is enacted into law could worsen this substantial negative effect on the Company's sales and, potentially, its business, cash flow, results of operations, financial position and prospects.

The Company faces intense competition from competitors' products which, in addition to other factors, could in certain circumstances lead to non-cash impairment charges.

The Company's products face intense competition from competitors' products. This competition may increase as new products enter the market. In such an event, the competitors' products may be safer or more effective, more convenient to use or more effectively marketed and sold than the Company's products. Alternatively, in the case of generic competition, including the generic availability of competitors' branded products, they may be equally safe and effective products that are sold at a substantially lower price than the Company's products. As a result, if the Company fails to maintain its competitive position, this could have a material adverse effect on its business, cash flow, results of operations, financial position and prospects. In addition, if products that were measured at fair value and capitalized in connection with mergers and acquisitions, such as *Saphris,* or former Merck/Schering Plough Partnership products, *Vytorin* or *Zetia*, experience difficulties in the market that negatively impact product cash flows, the Company may recognize material non-cash impairment charges with respect to the value of those products.

The Company faces pricing pressure with respect to its products.

The Company faces increasing pricing pressure globally from managed care organizations, government agencies and programs that could negatively affect the Company's sales and profit margins. In the United States, these include (i) practices of managed care groups and institutional and governmental purchasers, and (ii) U.S. federal laws and regulations related to Medicare and Medicaid, including the Medicare Prescription Drug Improvement and Modernization Act of 2003 and the Patient Protection and Affordable Care Act of 2010. Changes to the health care system enacted as part of health care reform in the United States, as well as increased purchasing power of entities that negotiate on behalf of Medicare, Medicaid, and private sector beneficiaries, could result in further pricing pressures. In addition, the Company faces the risk of litigation with the government over its pricing calculations.

Outside the United States, numerous major markets, including the EU, have pervasive government involvement in funding health care and, in that regard, fix the pricing and reimbursement of pharmaceutical and vaccine products. Consequently, in those markets, the Company is subject to government decision making and budgetary actions with respect to its products.

The Company expects pricing pressures to increase in the future.

The health care industry in the United States will continue to be subject to increasing regulation and political action.

The Company believes that the health care industry will continue to be subject to increasing regulation as well as political and legal action, as future proposals to reform the health care system are considered by Congress and state legislatures. In 2010, major health care reform was adopted into law in the United States.

Important market reforms have begun and will continue through full implementation in 2014. The new law is expected to expand access to health care to more than 32 million Americans by the end of the decade. In 2012, Merck incurred additional costs as a result of the law, including increased Medicaid rebates and other impacts that reduced revenues. In 2010, the minimum rebate to states participating in the Medicaid program increased from 15.1% to 23.1% on the Company's branded prescription drugs; the Medicaid rebate was extended to Medicaid Managed Care Organizations; and eligibility for the federal 340B drug discount program was extended to rural referral centers, sole community hospitals, critical access hospitals, certain free standing cancer hospitals, and certain additional children's hospitals.

In addition, the law requires pharmaceutical manufacturers to pay a 50% point of service discount to Medicare Part D beneficiaries when they are in the Medicare Part D coverage gap (i.e., the so-called "donut hole"). Approximately $210 million and $150 million was recorded by Merck as a reduction to revenue in 2012 and 2011, respectively, related to the donut hole provision. Also, the Company is required to pay an annual health care reform fee, which is assessed on all branded prescription drug manufacturers and importers. The fee is calculated based on the industry's total sales of branded prescription drugs to specified government programs. The percentage of a manufacturer's sales that are included is determined by a tiered scale based on the manufacturer's individual revenues. Each manufacturer's portion of the total annual fee is based on the manufacturer's proportion of the total includable sales in the prior year. The annual industry fee for 2012 was $2.8 billion and will be $2.8 billion in 2013. The Company recorded $190 million and $162 million of costs within *Marketing and administrative* expenses in 2012 and 2011, respectively, for the annual health care reform fee.

The Company cannot predict the likelihood of future changes in the health care industry in general, or the pharmaceutical industry in particular, or what impact they may have on the Company's results of operations, financial condition or business.

The current uncertainty in global economic conditions together with austerity measures being taken by certain governments could negatively affect the Company's operating results.

The current uncertainty in global economic conditions may result in a further slowdown to the global economy that could affect the Company's business by reducing the prices that drug wholesalers and retailers, hospitals, government agencies and managed health care providers may be able or willing to pay for the Company's products or by reducing the demand for the Company's products, which could in turn negatively impact the Company's sales and result in a material adverse effect on the Company's business, cash flow, results of operations, financial position and prospects.

Global efforts toward health care cost containment continue to exert pressure on product pricing and market access worldwide. In many international markets, government-mandated pricing actions have reduced prices of generic and patented drugs. In addition, other austerity measures negatively affected the Company's revenue performance in 2012. The Company anticipates these pricing actions and other austerity measures will continue to negatively affect revenue performance in 2013.

The Company continues to monitor the credit and economic conditions within Greece, Spain, Italy and Portugal, among other members of the EU. These economic conditions, as well as inherent variability of timing of cash receipts, have resulted in, and may continue to result in, an increase in the average length of time that it takes to collect on the accounts receivable outstanding in these countries and may also impact the likelihood of collecting 100% of outstanding accounts receivable. As of December 31, 2012, the Company's accounts receivable in Greece, Italy, Spain and Portugal totaled approximately $1.1 billion. Of this amount, hospital and public sector receivables were approximately $800 million in the aggregate, of which approximately 18%, 37%, 36% and 9% related to Greece, Italy, Spain and Portugal, respectively. As of December 31, 2012, the Company's total accounts receivable outstanding for more than one year were approximately $200 million, of which approximately 70% related to accounts receivable in Greece, Italy, Spain and Portugal, mostly comprised of hospital and public sector receivables.

If the conditions in Europe worsen and one or more countries in the euro zone exits the euro zone and reintroduces its legacy currency, the resulting economic and currency impacts in the affected markets and globally could have a material adverse effect on the Company's results.

The Company has significant global operations, which expose it to additional risks, and any adverse event could have a material negative impact on the Company's results of operations.

The extent of the Company's operations outside the United States are significant. Risks inherent in conducting a global business include:

- changes in medical reimbursement policies and programs and pricing restrictions in key markets;
- multiple regulatory requirements that could restrict the Company's ability to manufacture and sell its products in key markets;
- trade protection measures and import or export licensing requirements;
- foreign exchange fluctuations;
- diminished protection of intellectual property in some countries; and
- possible nationalization and expropriation.

In addition, there may be changes to the Company's business and political position if there is instability, disruption or destruction in a significant geographic region, regardless of cause, including war, terrorism, riot, civil insurrection or social unrest; and natural or man-made disasters, including famine, flood, fire, earthquake, storm or disease.

The Company has experienced difficulties and delays in manufacturing of certain of its products.

As previously disclosed, Merck has, in the past, experienced difficulties in manufacturing certain of its vaccines and other products. Similarly, the Company has, in the past, experienced difficulties manufacturing certain of its animal health products and is currently experiencing difficulty manufacturing certain women's health products. The Company is working on its manufacturing issues, but there can be no assurance of when or if these issues will be finally resolved.

In addition to the difficulties that the Company is experiencing currently, the Company may experience difficulties and delays inherent in manufacturing its products, such as (i) failure of the Company or any of its vendors or suppliers to comply with Current Good Manufacturing Practices and other applicable regulations and quality assurance guidelines that could lead to manufacturing shutdowns, product shortages and delays in product manufacturing; (ii) construction delays related to the construction of new facilities or the expansion of existing facilities, including those intended to support future demand for the Company's products; and (iii) other manufacturing or distribution problems including changes in manufacturing production sites and limits to manufacturing capacity due to regulatory requirements, changes in types of products produced, or physical limitations that could impact continuous supply. Manufacturing difficulties can result in product shortages, leading to lost sales.

The Company faces significant litigation related to Vioxx.

On September 30, 2004, Merck voluntarily withdrew *Vioxx*, its arthritis and acute pain medication, from the market worldwide. Although Merck has settled the major portion of the U.S. Product Liability litigation, the Company still faces material litigation arising from the voluntary withdrawal of *Vioxx*.

In addition to the *Vioxx* Product Liability Lawsuits and lawsuits from certain states that did not participate in a previously-disclosed settlement, various purported class actions and individual lawsuits have been brought against Merck and several current and former officers and directors of Merck alleging that Merck made false and misleading statements regarding *Vioxx* in violation of the federal securities laws and state laws (all of these suits are referred to as the "*Vioxx* Securities Lawsuits"). The *Vioxx* Securities Lawsuits have been transferred by the Judicial Panel on Multidistrict Litigation (the "JPML") to the U.S. District Court for the District of New Jersey before District Judge Stanley R. Chesler for inclusion in a nationwide MDL (the "Shareholder MDL"), and have been consolidated for all purposes. Merck has also been named as a defendant in actions in various countries outside the United States. (All of these suits are referred to as the "*Vioxx* International Lawsuits".)

The *Vioxx* litigation is discussed more fully in Item 8. "Financial Statements and Supplementary Data," Note 11. "Contingencies and Environmental Liabilities" below. The Company believes that it has meritorious defenses to the *Vioxx* Product Liability Lawsuits, *Vioxx* Securities Lawsuits and *Vioxx* International Lawsuits (collectively, the "*Vioxx* Lawsuits") and will vigorously defend against them. The Company's insurance coverage with respect to the *Vioxx* Lawsuits will not be adequate to cover its defense costs and any losses.

The Company is not currently able to estimate any additional amounts that it may be required to pay in connection with the *Vioxx* Lawsuits. These proceedings are still expected to continue for years and the Company cannot predict the course the proceedings will take. In view of the inherent difficulty of predicting the outcome of litigation, particularly where there are many claimants and the claimants seek unspecified damages, the Company is unable to predict the outcome of these matters, and at this time cannot reasonably estimate the possible loss or range of loss with respect to the remaining *Vioxx* Lawsuits. The Company has not established any material reserves for any potential liability relating to the remaining *Vioxx* Lawsuits although it has established reserves related to the settlement of the Canadian *Vioxx* litigation and with respect to certain other *Vioxx* Product Liability Lawsuits, including a previously-disclosed settlement relating to a lawsuit brought by a class of Missouri plaintiffs, all of which are discussed in Item 8. "Financial Statements and Supplementary Data," Note 11. "Contingencies and Environmental Liabilities" below.

A series of unfavorable outcomes in the *Vioxx* Lawsuits resulting in the payment of substantial damages could have a material adverse effect on the Company's business, cash flow, results of operations, financial position and prospects.

Issues concerning *Vytorin* and the ENHANCE clinical trial have had an adverse effect on sales of *Vytorin* and *Zetia* in the United States and results from the IMPROVE-IT trial could have a material adverse effect on such sales.

The Company sells *Vytorin* and *Zetia.* As previously disclosed, in January 2008, the Company announced the results of the ENHANCE clinical trial, an imaging trial in 720 patients with heterozygous familial hypercholesterolemia, a rare genetic condition that causes very high levels of LDL "bad" cholesterol and greatly increases the risk for premature coronary artery disease. As previously reported, despite the fact that ezetimibe/simvastatin 10/80 mg (*Vytorin*) significantly lowered LDL "bad" cholesterol more than simvastatin 80 mg alone, there was no significant difference between treatment with ezetimibe/simvastatin and simvastatin alone on the pre-specified primary endpoint, a change in the thickness of carotid artery walls over two years as measured by ultrasound. The IMPROVE-IT trial is underway and is designed to provide cardiovascular outcomes data for ezetimibe/simvastatin in patients presenting with acute coronary syndrome. No incremental benefit of ezetimibe/simvastatin on cardiovascular morbidity and mortality over and above that demonstrated for simvastatin has been established. In January 2009, the FDA announced that it had completed its review of the final clinical study report of ENHANCE. The FDA stated that the results from ENHANCE did not change its position that elevated LDL cholesterol is a risk factor for cardiovascular disease and that lowering LDL cholesterol reduces the risk for cardiovascular disease.

The IMPROVE-IT trial is scheduled for completion in 2014. In the IMPROVE-IT trial, blinded interim efficacy analyses were conducted by the DSMB for the trial when approximately 50% and 75% of the endpoints were accrued, respectively. In each case, the DSMB recommended continuing the trial without change in design. At the time of the second interim efficacy analysis, the DSMB stated it planned to review the data again in approximately nine months; that review has been scheduled for March 2013, at which point nine months of additional data will have been adjudicated. If, based on the results of that review, the trial were to be halted because of concerns related to *Vytorin*, that could have a material adverse effect on sales of *Vytorin* and *Zetia*.

These issues concerning the ENHANCE clinical trial have had an adverse effect on sales of *Vytorin* and *Zetia* and could continue to have an adverse effect on such sales. If the results of the IMPROVE-IT trial fail to demonstrate an incremental benefit of ezetimibe/simvastatin on cardiovascular morbidity and mortality over and above that demonstrated for simvastatin, sales of *Zetia* and *Vytorin* could be materially adversely affected. If sales of such products are materially adversely affected, the Company's business, cash flow, results of operations, financial position and prospects could also be materially adversely affected and the Company could be required to record a material non-cash impairment charge.

The Company may not be able to realize the expected benefits of its investments in emerging markets.

The Company has been taking steps to increase its presence in emerging markets. However, there is no guarantee that the Company's efforts to expand sales in emerging markets will succeed. Some countries within emerging markets may be especially vulnerable to periods of global financial instability or may have very limited resources to spend on health care. In order for the Company to successfully implement its emerging markets strategy, it must attract and retain qualified personnel. The Company may also be required to increase its reliance on third-party agents within less developed markets. In addition, many of these countries have currencies that fluctuate substantially and if such currencies devalue and the Company cannot offset the devaluations, the Company's financial performance within such countries could be adversely affected.

For instance, in February 2013, the Venezuelan government devalued its currency. As a result of that devaluation, the Company will recognize losses due to exchange.

For all these reasons, sales within emerging markets carry significant risks. However, a failure to continue to expand the Company's business in emerging markets could have a material adverse effect on the business, financial condition or results of the Company's operations.

The Company is exposed to market risk from fluctuations in currency exchange rates and interest rates.

The Company operates in multiple jurisdictions and, as such, virtually all sales are denominated in currencies of the local jurisdiction. Additionally, the Company has entered and will enter into acquisition, licensing, borrowings or other financial transactions that may give rise to currency and interest rate exposure.

Since the Company cannot, with certainty, foresee and mitigate against such adverse fluctuations, fluctuations in currency exchange rates and interest rates could negatively affect the Company's results of operations, financial position and cash flows.

In order to mitigate against the adverse impact of these market fluctuations, the Company will from time to time enter into hedging agreements. While hedging agreements, such as currency options and interest rate swaps, may limit some of the exposure to exchange rate and interest rate fluctuations, such attempts to mitigate these risks may be costly and not always successful.

The Company is subject to evolving and complex tax laws, which may result in additional liabilities that may affect results of operations.

The Company is subject to evolving and complex tax laws in the jurisdictions in which it operates. Significant judgment is required for determining the Company's tax liabilities, and the Company's tax returns are periodically examined by various tax authorities. The Company believes that its accrual for tax contingencies is adequate for all open years based on past experience, interpretations of tax law, and judgments about potential actions by tax authorities; however, due to the complexity of tax contingencies, the ultimate resolution of any tax matters may result in payments greater or less than amounts accrued.

In February 2012, President Obama's administration re-proposed significant changes to the U.S. international tax laws, including changes that would tax companies on "excess returns" attributable to certain offshore intangible assets, limit U.S. tax deductions for expenses related to un-repatriated foreign-source income and modify the U.S. foreign tax credit rules. Other potentially significant changes to the U.S. international laws, including a move toward a territorial tax system, have been set out by various Congressional committees. The Company cannot determine whether these proposals will be enacted into law or what, if any, changes may be made to such proposals prior to their being enacted into law. If these or other changes to the U.S. international tax laws are enacted, they could have a significant impact on the financial results of the Company.

In addition, the Company may be affected by changes in tax laws, including tax rate changes, changes to the laws related to the remittance of foreign earnings (deferral), or other limitations impacting the U.S. tax treatment of foreign earnings, new tax laws, and revised tax law interpretations in domestic and foreign jurisdictions.

Pharmaceutical products can develop unexpected safety or efficacy concerns.

Unexpected safety or efficacy concerns can arise with respect to marketed products, whether or not scientifically justified, leading to product recalls, withdrawals, or declining sales, as well as product liability, consumer fraud and/or other claims, including potential civil or criminal governmental actions.

Changes in laws and regulations could adversely affect the Company's business.

All aspects of the Company's business, including research and development, manufacturing, marketing, pricing, sales, litigation and intellectual property rights, are subject to extensive legislation and regulation. Changes in applicable federal and state laws and agency regulations could have a material adverse effect on the Company's business.

Reliance on third party relationships and outsourcing arrangements could adversely affect the Company's business.

The Company depends on third parties, including suppliers, alliances with other pharmaceutical and biotechnology companies, and third party service providers, for key aspects of its business including development, manufacture and commercialization of its products and support for its information technology systems. Failure of these third parties to meet their contractual, regulatory and other obligations to the Company or the development of factors that materially disrupt the relationships between the Company and these third parties could have a material adverse effect on the Company's business.

The Company is increasingly dependent on sophisticated information technology and infrastructure.

The Company is increasingly dependent on sophisticated information technology and infrastructure. The size and complexity of the Company's computer systems makes them potentially vulnerable to service interruption, malicious intrusion and random attacks. In addition, data privacy or security breaches by employees or others may pose a risk that data, including intellectual property or personal information, may be exposed to unauthorized individuals or to the public. There can be no assurance that the Company's efforts to protect its data and systems will prevent service interruption or the loss of critical or sensitive information which could result in financial, legal, business or reputational harm to the Company.

Negative events in the animal health industry could have a negative impact on future results of operations.

Future sales of key animal health products could be adversely affected by a number of risk factors including certain risks that are specific to the animal health business. For example, the outbreak of disease carried by animals, such as Bovine Spongiform Encephalopathy or mad cow disease, could lead to their widespread death and precautionary destruction as well as the reduced consumption and demand for animals, which could adversely impact the Company's results of operations. Also, the outbreak of any highly contagious diseases near the Company's main production sites could require the Company to immediately halt production of vaccines at such sites or force the Company to incur substantial expenses in procuring raw materials or vaccines elsewhere. Other risks specific to animal health include epidemics and pandemics, government procurement and pricing practices, weather and global agribusiness economic events. As the Animal Health segment of the Company's business becomes more significant, the impact of any such events on future results of operations would also become more significant.

Biologics carry unique risks and uncertainties, which could have a negative impact on future results of operations.

The successful development, testing, manufacturing and commercialization of biologics, particularly human and animal health vaccines, is a long, expensive and uncertain process. There are unique risks and uncertainties with biologics, including:

- There may be limited access to and supply of normal and diseased tissue samples, cell lines, pathogens, bacteria, viral strains and other biological materials. In addition, government regulations in multiple jurisdictions, such as the United States and the EU, could result in restricted access to, or transport or use of, such materials. If the Company loses access to sufficient sources of such materials, or if tighter restrictions are imposed on the use of such materials, the Company may not be able to conduct research activities as planned and may incur additional development costs.

- The development, manufacturing and marketing of biologics are subject to regulation by the FDA, the EMA and other regulatory bodies. These regulations are often more complex and extensive than the regulations applicable to other pharmaceutical products. For example, in the United States, a BLA, including both preclinical and clinical trial data and extensive data regarding the manufacturing procedures, is required for human vaccine candidates and FDA approval is required for the release of each manufactured commercial lot.
- Manufacturing biologics, especially in large quantities, is often complex and may require the use of innovative technologies to handle living micro-organisms. Each lot of an approved biologic must undergo thorough testing for identity, strength, quality, purity and potency. Manufacturing biologics requires facilities specifically designed for and validated for this purpose, and sophisticated quality assurance and quality control procedures are necessary. Slight deviations anywhere in the manufacturing process, including filling, labeling, packaging, storage and shipping and quality control and testing, may result in lot failures, product recalls or spoilage. When changes are made to the manufacturing process, the Company may be required to provide pre-clinical and clinical data showing the comparable identity, strength, quality, purity or potency of the products before and after such changes.
- Biologics are frequently costly to manufacture because production ingredients are derived from living animal or plant material, and most biologics cannot be made synthetically. In particular, keeping up with the demand for vaccines may be difficult due to the complexity of producing vaccines.
- The use of biologically derived ingredients can lead to allegations of harm, including infections or allergic reactions, or closure of product facilities due to possible contamination. Any of these events could result in substantial costs.

Product liability insurance for products may be limited, cost prohibitive or unavailable.

As a result of a number of factors, product liability insurance has become less available while the cost has increased significantly. With respect to product liability, the Company self-insures substantially all of its risk, as the availability of commercial insurance has become more restrictive. The Company has evaluated its risks and has determined that the cost of obtaining product liability insurance outweighs the likely benefits of the coverage that is available and, as such, has no insurance for certain product liabilities effective August 1, 2004, including liability for legacy Merck products first sold after that date. The Company will continually assess the most efficient means to address its risk; however, there can be no guarantee that insurance coverage will be obtained or, if obtained, will be sufficient to fully cover product liabilities that may arise.

Cautionary Factors that May Affect Future Results

(Cautionary Statements Under the Private Securities Litigation Reform Act of 1995)

This report and other written reports and oral statements made from time to time by the Company may contain so-called “forward-looking statements,” all of which are based on management’s current expectations and are subject to risks and uncertainties which may cause results to differ materially from those set forth in the statements. One can identify these forward-looking statements by their use of words such as “anticipates,” “expects,” “plans,” “will,” “estimates,” “forecasts,” “projects” and other words of similar meaning. One can also identify them by the fact that they do not relate strictly to historical or current facts. These statements are likely to address the Company’s growth strategy, financial results, product development, product approvals, product potential, and development programs. One must carefully consider any such statement and should understand that many factors could cause actual results to differ materially from the Company’s forward-looking statements. These factors include inaccurate assumptions and a broad variety of other risks and uncertainties, including some that are known and some that are not. No forward-looking statement can be guaranteed and actual future results may vary materially. The Company does not assume the obligation to update any forward-looking statement. The Company cautions you not to place undue reliance on these forward-looking statements. Although it is not possible to predict or identify all such factors, they may include the following:

- Competition from generic products as the Company's products, such as *Singulair* and *Maxalt*, lose patent protection.
- Increased "brand" competition in therapeutic areas important to the Company's long-term business performance.
- The difficulties and uncertainties inherent in new product development. The outcome of the lengthy and complex process of new product development is inherently uncertain. A drug candidate can fail at any stage of the process and one or more late-stage product candidates could fail to receive regulatory approval. New product candidates may appear promising in development but fail to reach the market because of efficacy or safety concerns, the inability to obtain necessary regulatory approvals, the difficulty or excessive cost to manufacture and/or the infringement of patents or intellectual property rights of others. Furthermore, the sales of new products may prove to be disappointing and fail to reach anticipated levels.
- Pricing pressures, both in the United States and abroad, including rules and practices of managed care groups, judicial decisions and governmental laws and regulations related to Medicare, Medicaid and health care reform, pharmaceutical reimbursement and pricing in general.
- Changes in government laws and regulations, including laws governing intellectual property, and the enforcement thereof affecting the Company's business.
- Efficacy or safety concerns with respect to marketed products, whether or not scientifically justified, leading to product recalls, withdrawals or declining sales.
- Significant litigation related to *Vioxx* and *Fosamax.*
- Legal factors, including product liability claims, antitrust litigation and governmental investigations, including tax disputes, environmental concerns and patent disputes with branded and generic competitors, any of which could preclude commercialization of products or negatively affect the profitability of existing products.
- Lost market opportunity resulting from delays and uncertainties in the approval process of the FDA and foreign regulatory authorities.
- Increased focus on privacy issues in countries around the world, including the United States and the EU. The legislative and regulatory landscape for privacy and data protection continues to evolve, and there has been an increasing amount of focus on privacy and data protection issues with the potential to affect directly the Company's business, including recently enacted laws in a majority of states in the United States requiring security breach notification.
- Changes in tax laws including changes related to the taxation of foreign earnings.
- Changes in accounting pronouncements promulgated by standard-setting or regulatory bodies, including the Financial Accounting Standards Board and the SEC, that are adverse to the Company.
- Economic factors over which the Company has no control, including changes in inflation, interest rates and foreign currency exchange rates.

This list should not be considered an exhaustive statement of all potential risks and uncertainties. See "Risk Factors" above.

Item 1B. Unresolved Staff Comments.

None

Item 2. Properties.

The Company's corporate headquarters is currently located in Whitehouse Station, New Jersey, although the Company has announced that it intends to move its headquarters to Summit, New Jersey in 2015. The Company's U.S. commercial operations are headquartered in Upper Gwynedd, Pennsylvania. The Company's U.S. pharmaceutical business is conducted through divisional headquarters located in Upper Gwynedd and Whitehouse Station. The Company's vaccines business is conducted through divisional headquarters located in West Point, Pennsylvania. Merck's Animal Health global headquarters functions are located in Summit, New Jersey. Principal U.S. research facilities are located in Rahway, Kenilworth and Summit, New Jersey, West Point, Pennsylvania, Palo Alto, California, Boston, Massachusetts, and Elkhorn, Nebraska (Animal Health). Principal research facilities outside the U.S. are located in the Netherlands, Switzerland and China. The Company also has production facilities for human health products at 15 locations in the United States and Puerto Rico. Outside the United States, through subsidiaries, the Company owns or has an interest in manufacturing plants or other properties in Australia, Canada, Japan, Singapore, South Africa, and other countries in Western Europe, Central and South America, and Asia.

Capital expenditures were $2.0 billion in 2012, $1.7 billion in 2011 and $1.7 billion in 2010. In the United States, these amounted to $1.3 billion for 2012, $1.2 billion for 2011 and $990 million in 2010. Abroad, such expenditures amounted to $662 million for 2012, $516 million for 2011 and $687 million for 2010.

The Company and its subsidiaries own their principal facilities and manufacturing plants under titles that they consider to be satisfactory. The Company considers that its properties are in good operating condition and that its machinery and equipment have been well maintained. Plants for the manufacture of products are suitable for their intended purposes and have capacities and projected capacities adequate for current and projected needs for existing Company products. Some capacity of the plants is being converted, with any needed modification, to the requirements of newly introduced and future products.

Item 3. Legal Proceedings.

The information called for by this Item is incorporated herein by reference to Note 11. "Contingencies and Environmental Liabilities" included in Part II, Item 8. "Financial Statements and Supplementary Data."

Item 4. Mine Safety Disclosures.

Not Applicable

Executive Officers of the Registrant (ages as of February 1, 2013)

At the time of the Merger, November 3, 2009, certain executive officers assumed their position in the newly merged company as noted below.

KENNETH C. FRAZIER — Age 58

December 2011 — Chairman, President and Chief Executive Officer, Merck & Co., Inc.

January 2011 — President and Chief Executive Officer, Merck & Co., Inc.

May 2010 — President, Merck & Co., Inc. — responsible for the Company's three largest worldwide divisions — Global Human Health, Merck Manufacturing Division and Merck Research Laboratories

November 2009 — Executive Vice President and President, Global Human Health, Merck & Co., Inc. — responsible for the Company's marketing and sales organizations worldwide, including the global pharmaceutical and vaccine franchises

August 2007 — Executive Vice President and President, Global Human Health, Merck & Co., Inc. — responsible for the Company's marketing and sales organizations worldwide, including the global pharmaceutical and vaccine franchises

ADELE D. AMBROSE — Age 56

November 2009 — Senior Vice President and Chief Communications Officer, Merck & Co., Inc. — responsible for the Global Communications organization

December 2007 — Vice President and Chief Communications Officer, Merck & Co., Inc. — responsible for the Global Communications organization

JOHN CANAN — Age 56

November 2009 — Senior Vice President Finance-Global Controller, Merck & Co., Inc. — responsible for the Company's global controller's organization including all accounting, controls, external reporting and financial standards and policies

January 2008 — Senior Vice President and Controller, Merck & Co., Inc. — responsible for the Corporate Controller's Group

WILLIE A. DEESE — Age 57

November 2009 — Executive Vice President and President, Merck Manufacturing Division, Merck & Co., Inc. — responsible for the Company's global manufacturing, procurement, and distribution and logistics functions

January 2008 — Executive Vice President and President, Merck Manufacturing Division, Merck & Co., Inc. — responsible for the Company's global manufacturing, procurement, and distribution and logistics functions

RICHARD R. DELUCA, JR. — Age 50

September 2011 — Executive Vice President and President, Merck Animal Health, Merck & Co., Inc. — responsible for the Merck Animal Health organization

Prior to September 2011, Mr. DeLuca was Chief Financial Officer, Becton Dickinson Biosciences (a medical technology company) since 2010 and President, Wyeth's Fort Dodge Animal Health division from 2007 to 2010. He also served as Chief Operating Officer, Fort Dodge from 2006 to 2007 and Executive Vice President and Chief Financial Officer from 2002 to 2006.

CUONG VIET DO — Age 46

October 2011 — Executive Vice President and Chief Strategy Officer, Merck & Co., Inc. — responsible for leading the formulation and execution of the Company's long term strategic plan

Prior to October 2011, Mr. Do was Senior Vice President, Corporate Strategy and Business Development, TE Connectivity (a global company that designs, manufactures and markets products for customers in a variety of industries) from 2009 to 2011 and Senior Vice President and Chief Strategy Officer, Lenovo (a personal technology company) from 2006 to 2009.

CLARK GOLESTANI — Age 46

December 2012 — Executive Vice President and Chief Information Officer, Merck & Co., Inc. — responsible for Merck's global information technology (IT)

August 2008 — Vice President, Merck Research Laboratories Information Technology, Merck & Co., Inc. — responsible for global IT for Merck's Research & Development division, including Basic Research, PreClinical, Clinical and Regulatory

November 2006 — Vice President, Corporate Information Technology, Merck & Co., Inc. — responsible for global IT supporting Finance, Human Resources, Procurement, Legal, Public Affairs, Site Services, Real Estate, and Shared Business Services operations

MIRIAN M. GRADDICK-WEIR — Age 58

November 2009 — Executive Vice President, Human Resources, Merck & Co., Inc. — responsible for the Global Human Resources organization

January 2008 — Executive Vice President, Human Resources, Merck & Co., Inc. — responsible for the Global Human Resources organization

BRIDGETTE P. HELLER — Age 51

March 2010 — Executive Vice President and President, Merck Consumer Care, Merck & Co., Inc. — responsible for the Merck Consumer Care organization

Prior to March 2010, Ms. Heller was President, Johnson & Johnson's Global Baby Business Unit from 2007 to 2010.

MICHAEL J. HOLSTON — Age 50

June 2012 — Executive Vice President and Chief Ethics and Compliance Officer, Merck & Co., Inc. — responsible for the Company's compliance function, including Global Safety & Environment, Systems Assurance, Ethics and Privacy

Prior to June 2012, Mr. Holston was Executive Vice President, General Counsel and Board Secretary for Hewlett-Packard Company (a technology company) since 2007, where he oversaw the legal, compliance, government affairs, privacy and ethics operations.

PETER N. KELLOGG — Age 56

November 2009 — Executive Vice President and Chief Financial Officer, Merck & Co., Inc. — responsible for the Company's worldwide financial organization, investor relations, corporate development and licensing, and the Company's joint venture relationships

August 2007 — Executive Vice President and Chief Financial Officer, Merck & Co., Inc. — responsible for the Company's worldwide financial organization, investor relations, corporate development and licensing, and the Company's joint venture relationships

PETER S. KIM — Age 54

November 2009 — Executive Vice President and President, Merck Research Laboratories, Merck & Co., Inc. — responsible for the Company's research and development efforts worldwide

January 2008 — Executive Vice President and President, Merck Research Laboratories, Merck & Co., Inc. — responsible for the Company's research and development efforts worldwide

BRUCE N. KUHLIK — Age 56

November 2009 — Executive Vice President and General Counsel, Merck & Co., Inc. — responsible for legal, communications, and public policy functions

January 2008 — Executive Vice President and General Counsel, Merck & Co., Inc. — responsible for legal, communications, and public policy functions

MICHAEL ROSENBLATT, M.D. — Age 65

December 2009 — Executive Vice President and Chief Medical Officer, Merck & Co., Inc. — the Company's primary voice to the global medical community on critical issues such as patient safety and oversight for the Company's Global Center for Scientific Affairs

Prior to December 2009, Dr. Rosenblatt was the Dean of Tufts University School of Medicine since 2003.

ADAM H. SCHECHTER — Age 48

May 2010 — Executive Vice President and President, Global Human Health, Merck & Co., Inc. — responsible for the Company's pharmaceutical and vaccine worldwide business

November 2009 — President, Global Human Health, U.S. Market-Integration Leader, Merck & Co., Inc. — commercial responsibility in the United States for the Company's portfolio of prescription medicines. Leader for the integration efforts for the Merck/Schering-Plough merger across all divisions and functions.

August 2007 — President, Global Pharmaceuticals, Global Human Health, Merck & Co., Inc. — global responsibilities for the Company's atherosclerosis/cardiovascular, diabetes/obesity, oncology, specialty/neuroscience, respiratory, bone, arthritis and analgesia franchises as well as commercial responsibility in the United States for the Company's portfolio of prescription medicines

All officers listed above serve at the pleasure of the Board of Directors. None of these officers was elected pursuant to any arrangement or understanding between the officer and the Board.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

The principal market for trading of the Company's Common Stock is the New York Stock Exchange ("NYSE") under the symbol MRK. The Common Stock market price information set forth in the table below is based on historical NYSE market prices.

The following table also sets forth, for the calendar periods indicated, the dividend per share information.

Cash Dividends Paid per Common Share

	Year	4th Q	3rd Q	2nd Q	1st Q
2012	**$1.68**	**$ 0.42**	**$ 0.42**	**$ 0.42**	**$ 0.42**
2011	$1.52	$ 0.38	$ 0.38	$ 0.38	$ 0.38

Common Stock Market Prices

2012	**4th Q**	**3rd Q**	**2nd Q**	**1st Q**
High	**$48.00**	**$45.70**	**$41.75**	**$39.43**
Low	**$40.02**	**$41.06**	**$37.02**	**$36.91**
2011				
High	$37.90	$36.56	$37.65	$37.62
Low	$30.54	$29.47	$33.00	$31.06

As of January 31, 2013, there were approximately 156,850 shareholders of record.

Equity Compensation Plan Information

The following table summarizes information about the options, warrants and rights and other equity compensation under the Company's equity compensation plans as of the close of business on December 31, 2012. The table does not include information about tax qualified plans such as the MSD Employee Savings and Security Plan and the Schering-Plough Employees' Savings Plan.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders[1]	165,756,073[2]	$39.47	179,527,854
Equity compensation plans not approved by security holders	—	—	—
Total	165,756,073	$39.47	179,527,854

(1) *Includes options to purchase shares of Company Common Stock and other rights under the following shareholder-approved plans: the Merck Sharp & Dohme 2001, 2004, 2007 and 2010 Incentive Stock Plans, the Merck & Co., Inc. 2001, 2006 and 2010 Non-Employee Directors Stock Option Plans, and the Merck & Co., Inc. Schering-Plough 1997, 2002 and 2006 Stock Incentive Plans.*

(2) *Excludes approximately 18,216,551 shares of restricted stock units and 2,255,251 performance share units (assuming maximum payouts) under the Merck Sharp & Dohme 2004, 2007 and 2010 Incentive Stock Plans and 4,526,616 shares of restricted stock units and 247,410 performance share units (excluding accrued dividends) under the Merck & Co., Inc. Schering-Plough 2006 Stock Incentive Plan. Also excludes 318,476 shares of phantom stock deferred under the MSD Employee Deferral Program and 473,582 shares of phantom stock deferred under the MSD Directors Deferral Program.*

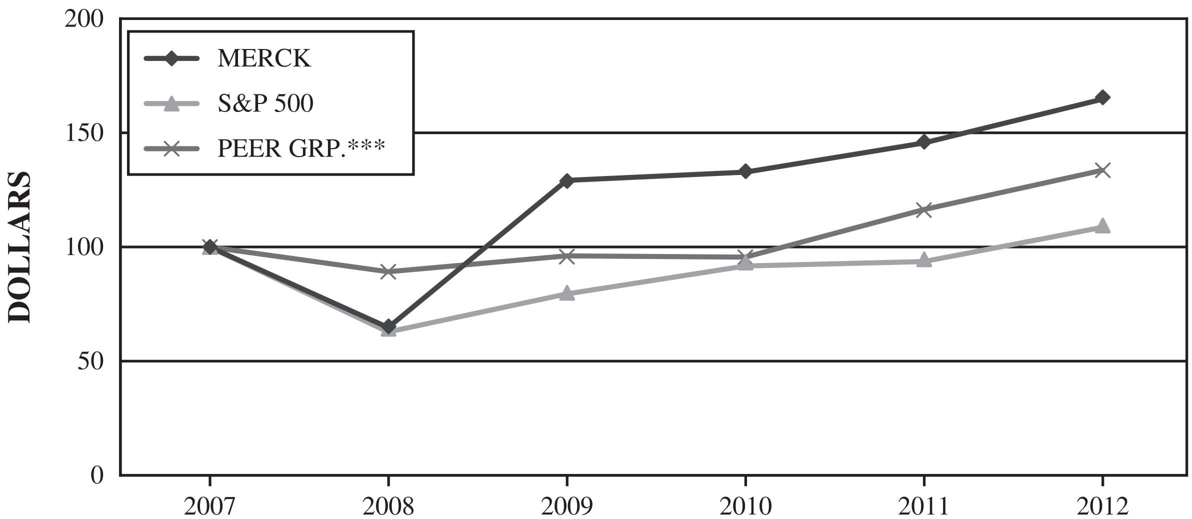
Performance Graph

The following graph assumes a $100 investment on December 31, 2007, and reinvestment of all dividends, in each of the Company's Common Shares, the S&P 500 Index, and a composite peer group of the major U.S.-based pharmaceutical companies, which are: Abbott Laboratories, Bristol-Myers Squibb Company, Johnson & Johnson, Eli Lilly and Company, and Pfizer Inc.

Comparison of Five-Year Cumulative Total Return*

Merck & Co., Inc., Composite Peer Group and S&P 500 Index

	End of Period Value	2012/2007 CAGR**
MERCK	$165	11%
PEER GRP.***	134	6
S&P 500	109	2



	2007	2008	2009	2010	2011	2012
MERCK	100.00	64.90	129.31	132.97	145.66	164.78
PEER GRP.	100.00	89.16	96.19	95.77	116.41	133.75
S&P 500	100.00	63.01	79.69	91.71	93.62	108.60

* *The Performance Graph reflects Schering-Plough's stock performance from December 31, 2007 through the close of the Merger and Merck's stock performance from November 3, 2009 through December 31, 2012. Assumes the cash component of the merger consideration was reinvested in Merck stock at the closing price on November 3, 2009.*

** *Compound Annual Growth Rate*

*** *On October 15, 2009, Wyeth and Pfizer Inc. completed their previously announced merger (the "Pfizer/Wyeth Merger") where Wyeth became a wholly-owned subsidiary of Pfizer Inc. As discussed, on November 3, 2009, Merck and Schering-Plough completed the Merger (together with the Pfizer/Wyeth Merger, the "Transactions") in which Merck (subsequently renamed Merck Sharp & Dohme Corp. ("MSD")) became a wholly-owned subsidiary of Schering-Plough (subsequently renamed Merck & Co., Inc.). As a result of the Transactions, Wyeth and MSD no longer exist as publicly traded entities and ceased all trading of their common stock as of the close of business on their respective merger dates. Wyeth and MSD have been permanently removed from the peer group index.*

Item 6. Selected Financial Data.

The following selected financial data should be read in conjunction with Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" and consolidated financial statements and notes thereto contained in Item 8. "Financial Statements and Supplementary Data" of this report.

Merck & Co., Inc. and Subsidiaries
($ in millions except per share amounts)

	2012(1)	2011(2)	2010(3)	2009(4)	2008(5)
Results for Year:					
Sales	**$ 47,267**	$ 48,047	$ 45,987	$ 27,428	$ 23,850
Materials and production	**16,446**	16,871	18,396	9,019	5,583
Marketing and administrative	**12,776**	13,733	13,125	8,543	7,377
Research and development	**8,168**	8,467	11,111	5,845	4,805
Restructuring costs	**664**	1,306	985	1,634	1,033
Equity income from affiliates	**(642)**	(610)	(587)	(2,235)	(2,561)
Other (income) expense, net	**1,116**	946	1,304	(10,668)	(2,318)
Income before taxes	**8,739**	7,334	1,653	15,290	9,931
Taxes on income	**2,440**	942	671	2,268	1,999
Net income	**6,299**	6,392	982	13,022	7,932
Less: Net income attributable to noncontrolling interests	**131**	120	121	123	124
Net income attributable to Merck & Co., Inc.	**6,168**	6,272	861	12,899	7,808
Basic earnings per common share attributable to Merck & Co., Inc. common shareholders	**$2.03**	$2.04	$0.28	$5.67	$3.65
Earnings per common share assuming dilution attributable to Merck & Co., Inc. common shareholders	**$2.00**	$2.02	$0.28	$5.65	$3.63
Cash dividends declared	**5,173**	4,818	4,730	3,598	3,250
Cash dividends paid per common share	**$1.68**	$1.52	$1.52	$1.52 (6)	$1.52
Capital expenditures	**1,954**	1,723	1,678	1,461	1,298
Depreciation	**1,999**	2,351	2,638	1,654	1,445
Average common shares outstanding (millions)	**3,041**	3,071	3,095	2,268	2,136
Average common shares outstanding assuming dilution (millions)	**3,076**	3,094	3,120	2,273	2,143
Year-End Position:					
Working capital	**$ 16,509**	$ 16,936	$ 13,423	$ 12,791	$ 4,794
Property, plant and equipment, net	**16,030**	16,297	17,082	18,279	12,000
Total assets	**106,132**	105,128	105,781	112,314	47,196
Long-term debt	**16,254**	15,525	15,482	16,095	3,943
Total equity	**55,463**	56,943	56,805	61,485	21,167
Year-End Statistics:					
Number of stockholders of record	**157,400**	166,100	171,000	175,600	165,700
Number of employees	**83,000**	86,000	94,000	100,000	55,200

(1) *Amounts for 2012 include the amortization of purchase accounting adjustments, a net charge recorded in connection with a litigation settlement, in-process research and development impairment charges reflected in research and development expenses, the impact of restructuring actions and the favorable impact of certain tax items.*

(2) *Amounts for 2011 include the amortization of purchase accounting adjustments, in-process research and development impairment charges reflected in research and development expenses, the impact of restructuring actions, an arbitration settlement charge, and the favorable impact of certain tax items, including a net favorable impact of approximately $700 million relating to the settlement of a federal income tax audit.*

(3) *Amounts for 2010 include the amortization of purchase accounting adjustments, in-process research and development impairment charges of $2.4 billion reflected in research and development expenses, the impact of restructuring actions, a reserve related to* Vioxx *litigation, a gain recognized on AstraZeneca LP's exercise of its option to acquire certain assets from the Company and the favorable impact of certain tax items.*

(4) *Amounts for 2009 include the impact of the merger with Schering-Plough Corporation on November 3, 2009, including the recognition of a gain representing the fair value step-up of Merck's previously held interest in the Merck/Schering-Plough partnership as a result of obtaining a controlling interest and the amortization of purchase accounting adjustments recorded in the post-merger period. Also included in 2009, is a gain on the sale of Merck's interest in Merial Limited, the favorable impact of certain tax items and the impact of restructuring actions.*

(5) *Amounts for 2008 include a gain on distribution from AstraZeneca LP, a gain related to the sale of the remaining worldwide rights to* Aggrastat*, the favorable impact of certain tax items, the impact of restructuring actions and an expense for a contribution to the Merck Foundation.*

(6) *Amount reflects dividends paid to common shareholders of Merck. In addition, approximately $144 million of dividends were paid subsequent to the merger with Schering-Plough, and $431 million were paid prior to the merger, relating to common stock and preferred stock dividends declared by Schering-Plough in 2009.*

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Description of Merck's Business

Merck & Co., Inc. ("Merck" or the "Company") is a global health care company that delivers innovative health solutions through its prescription medicines, vaccines, biologic therapies, animal health, and consumer care products, which it markets directly and through its joint ventures. The Company's operations are principally managed on a products basis and are comprised of four operating segments, which are the Pharmaceutical, Animal Health, Consumer Care and Alliances segments, and one reportable segment, which is the Pharmaceutical segment. The Pharmaceutical segment includes human health pharmaceutical and vaccine products marketed either directly by the Company or through joint ventures. Human health pharmaceutical products consist of therapeutic and preventive agents, generally sold by prescription, for the treatment of human disorders. The Company sells these human health pharmaceutical products primarily to drug wholesalers and retailers, hospitals, government agencies and managed health care providers such as health maintenance organizations, pharmacy benefit managers and other institutions. Vaccine products consist of preventive pediatric, adolescent and adult vaccines, primarily administered at physician offices. The Company sells these human health vaccines primarily to physicians, wholesalers, physician distributors and government entities. The Company also has animal health operations that discover, develop, manufacture and market animal health products, including vaccines, which the Company sells to veterinarians, distributors and animal producers. Additionally, the Company has consumer care operations that develop, manufacture and market over-the-counter, foot care and sun care products, which are sold through wholesale and retail drug, food chain and mass merchandiser outlets, as well as club stores and specialty channels.

Overview

Merck continued to execute on its strategic priorities during 2012 despite facing several business challenges, including the August U.S. patent expiration for *Singulair*, a medicine indicated for the chronic treatment of asthma and the relief of symptoms of allergic rhinitis. Worldwide sales were $47.3 billion in 2012, a decline of 2% compared with 2011, including a 3% unfavorable effect from foreign exchange. Excluding the impact of foreign exchange, sales increased 1% reflecting growth of key products and within key geographic regions which offset the impact of the U.S. *Singulair* patent expiration. The Company also reduced operating expenses by efficiently managing costs through targeted reductions. In addition, the Company generated new clinical data and advanced certain key research and development pipeline programs.

The Company's four-part growth strategy is focused on; one, executing on its core business, which includes its largest markets, its core brands, new launch brands, and research and development efforts targeted at therapeutic areas with the greatest future patient demand and scientific opportunity; two, expanding geographically into high-growth markets; three, extending into complementary businesses of consumer care and animal health; and four, effectively managing costs while continuing to invest for future growth.

Beginning with the Company's sales performance in its largest markets during 2012, despite the adverse effects of the U.S. *Singulair* patent expiry which caused a significant and rapid decline in U.S. *Singulair* sales, sales in the United States were relatively flat compared to the prior year reflecting strong growth of key brands including *Januvia* and *Janumet*, treatments for type 2 diabetes, *Zostavax*, a vaccine to help prevent shingles (herpes zoster), *Gardasil*, a vaccine to help prevent certain diseases caused by four types of human papillomavirus ("HPV"), *Victrelis*, a treatment for chronic hepatitis C, and *Isentress*, an antiretroviral therapy for use in combination therapy for the treatment of HIV-1 infection. Turning to Europe and Canada, the Company continues to experience positive volume growth trends for many of its key brands, including *Victrelis, Januvia*, *Janumet*, and *Simponi*, a treatment for inflammatory diseases; however, this growth only partially offset increased generic erosion and the price declines stemming from the economic issues and related fiscal austerity measures in this region.

With respect to research and development efforts, the Company continued the advancement of drug candidates through its pipeline in 2012. The Company currently has three candidates under review with the U.S. Food and Drug Administration (the "FDA"): MK-4305, suvorexant, an investigational treatment for insomnia; MK-8616, sugammadex sodium injection, a medication for the reversal of certain muscle relaxants used during surgery; and MK-0653C, an investigational combination of ezetimibe and atorvastatin for the treatment of primary or mixed hyperlipidemia. MK-8109, vintafolide, an investigational cancer candidate, is under review in the European Union (the “EU”). In addition, the Company currently has 16 candidates in Phase III development and anticipates filing a New Drug Application (“NDA”) or a Biologics License Application (“BLA”), as applicable, with the FDA with respect to several of these candidates in 2013.

In December 2012, the Company announced the HPS2-THRIVE (Heart Protection Study 2-Treatment of HDL to Reduce the Incidence of Vascular Events) study of *Tredaptive* (extended-release niacin/laropiprant) did not meet its primary endpoint. As a result, the Company does not plan to seek regulatory approval for the medicine in the United States. In January 2013, Merck began taking steps to suspend the availability of *Tredaptive* outside the United States. Also, on February 1, 2013, the Company announced that it had recently received and was reviewing safety and efficacy data from a Phase III study involving MK-0822, odanacatib, the Company’s investigational treatment for osteoporosis in post-menopausal women. As a result of its review of this data, the Company concluded that review of additional data from the previously planned, ongoing extension study was warranted and that filing an application for approval with the FDA should be delayed. As previously announced, the Company is conducting a blinded extension of the trial in approximately 8,200 women, which will provide additional safety and efficacy data. Merck now anticipates that it will file applications for approval of odanacatib in 2014 with additional data from the extension trial. The Company continues to believe that odanacatib will have the potential to address unmet medical needs in patients with osteoporosis.

Merck continues to pursue opportunities for establishing external alliances to complement its substantial internal research capabilities, including research collaborations, as well as licensing preclinical and clinical compounds and technology platforms that have the potential to drive both near- and long-term growth. During 2012, the Company completed a variety of transactions spanning different therapeutic areas and clinical stages including licensing agreements with Endocyte, Inc. (“Endocyte”) for vintafolide (MK-8109), an investigational cancer candidate, and with AiCuris for a portfolio of investigational medicines targeting human cytomegalovirus, including letermovir (MK-8228).

Consistent with the second element of the Company’s strategy to expand geographically in high-growth markets such as Japan and key emerging markets, the Company continued to invest in these markets in 2012. Emerging market sales grew 4% in 2012, including a 4% unfavorable impact of foreign exchange, despite the loss of sales from *Remicade* and *Simponi*, treatments for inflammatory diseases, in markets relinquished to Johnson & Johnson (“J&J”) as part of the arbitration settlement agreement in 2011 as discussed below. China continues to be an important growth driver with sales exceeding $1.0 billion in 2012, representing growth of 25% over the prior year, including a 3% favorable effect from foreign exchange. Growth in Japan was 6% during 2012, tempered by generic competition and the biennial price cuts early in the year. Merck has entered into several transactions designed to strengthen its presence in the emerging markets in the longer term. The Company’s joint venture with Simcere Pharmaceutical Group in China began preliminary operations in late-2012.

The third component of Merck’s strategy relates to the complementary businesses of Consumer Care and Animal Health. Merck’s Animal Health business continues as a solid contributor with 4% revenue growth in 2012, including a 5% unfavorable effect from foreign exchange, reflecting growth in the cattle, poultry, companion animal and swine product lines. Sales of Consumer Care products grew 6% in 2012, including a 1% unfavorable effect from foreign exchange, led by the *Dr. Scholl’s* franchise and higher sales of *Coppertone*, *MiraLAX* and *Claritin*.

As noted, the last element of the Company’s strategy is to tightly manage costs while also investing for growth. Consistent with these efforts, Merck remains committed to driving continuous productivity improvements across the enterprise and continues to realize cost savings across all areas of the Company. These savings result from various actions, including the Merger Restructuring Program discussed below, previously announced ongoing cost reduction activities, as well as from non-restructuring-related activities. As of the end of 2012, the Company had achieved its projected $3.5 billion in annual net cost savings from these activities since the merger with Schering-Plough Corporation (“Schering-Plough”) (the “Merger”).

The global restructuring program that was initiated in conjunction with the integration of the legacy Merck and legacy Schering-Plough businesses (the “Merger Restructuring Program”) is intended to optimize the cost structure of the combined company. The workforce reductions associated with this plan relate to the elimination of positions in sales, administrative and headquarters organizations, as well as from the sale or closure of certain manufacturing and research and development sites and the consolidation of office facilities. The Company recorded total pretax restructuring costs of $951 million in 2012, $1.8 billion in 2011 and $1.8 billion in

2010 related to this program. Costs associated with the Company's restructuring actions are included in *Materials and production* costs, *Marketing and administrative* expenses, *Research and development* expenses and *Restructuring costs*. The restructuring actions under the Merger Restructuring Program are expected to be substantially completed by the end of 2013, with the exception of certain actions, principally manufacturing-related. Subsequent to the Merger, the Company has rationalized a number of manufacturing sites worldwide. The remaining actions under this program will result in additional manufacturing facility rationalizations, which are expected to be substantially completed by 2016. The Company now expects the estimated total cumulative pretax costs for this program to be approximately $7.2 billion to $7.5 billion. The Company estimates that approximately two-thirds of the cumulative pretax costs relate to cash outlays, primarily related to employee separation expense. Approximately one-third of the cumulative pretax costs are non-cash, relating primarily to the accelerated depreciation of facilities to be closed or divested. The Company expects the Merger Restructuring Program to yield annual savings by the end of 2013 of approximately $3.5 billion to $4.0 billion and annual savings upon completion of the program of approximately $4.0 billion to $4.6 billion.

In November 2012, Merck's Board of Directors raised the Company's quarterly dividend to $0.43 per share from $0.42 per share.

In February 2013, Merck reached an agreement in principle with plaintiffs to resolve two federal securities class-action lawsuits pending in the U.S. District Court for the District of New Jersey against Merck, Schering-Plough and certain of their current and former officers and directors (the "ENHANCE Litigation"). Under the proposed agreement, Merck will pay $215 million to resolve the securities class action against all of the Merck defendants and $473 million to resolve the securities class action against all of the Schering-Plough defendants. In connection with the settlement, Merck recorded a pretax and after-tax charge of $493 million in 2012 which reflects $195 million of anticipated insurance recoveries.

Earnings per common share assuming dilution attributable to common shareholders ("EPS") for 2012 were $2.00, which reflect a net unfavorable impact resulting from acquisition-related costs and restructuring costs, as well as the charge related to the ENHANCE Litigation noted above. Non-GAAP EPS in 2012 were $3.82 excluding these items (see "Non-GAAP Income and Non-GAAP EPS" below).

Competition and the Health Care Environment

Competition

The markets in which the Company conducts its business and the pharmaceutical industry are highly competitive and highly regulated. The Company's competitors include other worldwide research-based pharmaceutical companies, smaller research companies with more limited therapeutic focus, and generic drug and consumer health care manufacturers. The Company's operations may be affected by technological advances of competitors, industry consolidation, patents granted to competitors, competitive combination products, new products of competitors, the generic availability of competitors' branded products, new information from clinical trials of marketed products or post-marketing surveillance and generic competition as the Company's products mature. In addition, patent positions are increasingly being challenged by competitors, and the outcome can be highly uncertain. An adverse result in a patent dispute can preclude commercialization of products or negatively affect sales of existing products and could result in the recognition of an impairment charge with respect to certain products. Competitive pressures have intensified as pressures in the industry have grown. The effect on operations of competitive factors and patent disputes cannot be predicted.

Pharmaceutical competition involves a rigorous search for technological innovations and the ability to market these innovations effectively. With its long-standing emphasis on research and development, the Company is well positioned to compete in the search for technological innovations. Additional resources required to meet market challenges include quality control, flexibility to meet customer specifications, an efficient distribution system and a strong technical information service. The Company is active in acquiring and marketing products through external alliances, such as joint ventures and licenses, and has been refining its sales and marketing efforts to further address changing industry conditions. However, the introduction of new products and processes by competitors may result in price reductions and product displacements, even for products protected by patents. For example, the number of compounds available to treat a particular disease typically increases over time and can result in slowed sales growth for the Company's products in that therapeutic category.

The highly competitive animal health business is affected by several factors including regulatory and legislative issues, scientific and technological advances, product innovation, the quality and price of the Company's products, effective promotional efforts and the frequent introduction of generic products by competitors.

The Company's consumer care operations face competition from other consumer health care businesses as well as retailers who carry their own private label brands. The Company's competitive position is affected by several factors, including regulatory and legislative issues, scientific and technological advances, the quality and price of the Company's products, promotional efforts and the growth of lower cost private label brands.

Health Care Environment

Global efforts toward health care cost containment continue to exert pressure on product pricing and market access. In the United States, federal and state governments for many years also have pursued methods to reduce the cost of drugs and vaccines for which they pay. For example, federal laws require the Company to pay specified rebates for medicines reimbursed by Medicaid and to provide discounts for outpatient medicines purchased by certain Public Health Service entities and hospitals serving a disproportionate share of low income or uninsured patients.

Against this backdrop, the United States enacted major health care reform legislation in 2010, which began to be implemented in 2010. Various insurance market reforms have advanced and will continue through full implementation in 2014. The law is expected to expand access to health care to about 32 million Americans by the end of the decade who did not previously have insurance coverage. With respect to the effect of the law on the pharmaceutical industry, the mandated Medicaid rebate increased from 15.1% to 23.1%, expanded the rebate to Medicaid managed care utilization, and increased the types of entities eligible for the federal 340B drug discount program. The law also requires pharmaceutical manufacturers to pay a 50% point of service discount to Medicare Part D beneficiaries when they are in the Medicare Part D coverage gap (i.e., the so-called "donut hole"). Approximately $210 million and $150 million was recorded by Merck as a reduction to revenue in 2012 and 2011, respectively, related to the donut hole provision. Also, pharmaceutical manufacturers are now required to pay an annual health care reform fee. The total annual industry fee was $2.8 billion in 2012 and will be $2.8 billion in 2013. The fee is assessed on each company in proportion to its share of sales to certain government programs, such as Medicare and Medicaid. The Company recorded $190 million and $162 million of costs within *Marketing and administrative* expenses in 2012 and 2011, respectively, for the annual health care reform fee.

The Company also faces increasing pricing pressure globally from managed care organizations, government agencies and programs that could negatively affect the Company's sales and profit margins. In the United States, these include (i) practices of managed care groups and institutional and governmental purchasers, and (ii) U.S. federal laws and regulations related to Medicare and Medicaid, including the Medicare Prescription Drug Improvement and Modernization Act of 2003 and the Patient Protection and Affordable Care Act of 2010. Changes to the health care system enacted as part of health care reform in the United States, as well as increased purchasing power of entities that negotiate on behalf of Medicare, Medicaid, and private sector beneficiaries, could result in further pricing pressures.

In addition, in the effort to contain the U.S. federal deficit, the pharmaceutical industry could be considered a potential source of savings via legislative proposals that have been debated but not enacted. These types of revenue generating or cost saving proposals include additional direct price controls in the Medicare prescription drug program (Part D). In addition, Congress may again consider proposals to allow, under certain conditions, the importation of medicines from other countries. It remains very uncertain as to what proposals, if any, may be included as part of future federal budget deficit reduction proposals that would directly or indirectly affect the Company.

Efforts toward health care cost containment remain intense in several European countries. Many countries have announced austerity measures, which include the implementation of pricing actions to reduce prices of generic and patented drugs and mandatory switches to generic drugs. While the Company is taking steps to mitigate the impact in the EU, the austerity measures continued to negatively affect the Company's revenue performance in 2012 and the Company anticipates the austerity measures will continue to negatively affect revenue performance in 2013.

Additionally, the global economic downturn and the sovereign debt issues in certain European countries, among other factors, have adversely affected foreign receivables in certain European countries. While the Company continues to receive payment on these receivables, these conditions have resulted in an increase in the average length of time it takes to collect accounts receivable outstanding thereby adversely affecting cash flows.

Governments in many emerging markets are also focused on constraining health care costs and have enacted price controls and related measures that aim to put pressure on the price of pharmaceuticals and constrain market access. The Company anticipates that pricing pressures and market access challenges will continue in 2013 to varying degrees in the emerging markets.

The Company's focus on and share of revenue from emerging markets has increased. Countries in these markets may be subject to conditions that can affect the Company's efforts to continue to grow in emerging markets, including potential political instability, significant currency fluctuation and controls, financial crises, limited or changing availability of funding for health care, and other developments that may adversely impact the business environment for the Company. Further, the Company may engage third-party agents to assist in operating in emerging market countries, which may affect its ability to realize continued growth and may also increase the Company's risk exposure.

The full impact of health care reform, as well as continuing budget pressures on governments around the world, cannot be predicted at this time.

In addressing cost containment pressures, the Company engages in public policy advocacy with policymakers and continues to attempt to demonstrate that its medicines provide value to patients and to those who pay for health care. The Company seeks to work with government policymakers to encourage a long-term approach to sustainable health care financing that ensures access to innovative medicines and does not disproportionately target pharmaceuticals as a source of budget savings. In markets with historically low rates of government health care spending, the Company encourages those governments to increase their investments in order to improve their citizens' access to appropriate health care, including medicines.

Certain markets outside of the United States have implemented health technology assessments and other cost management strategies which require additional data, reviews and administrative processes, all of which increase the complexity and costs of obtaining product reimbursement and exert downward pressure on reimbursement available and obtained.

Operating conditions have become more challenging under the global pressures of competition, industry regulation and cost containment efforts. Although no one can predict the effect of these and other factors on the Company's business, the Company continually takes measures to evaluate, adapt and improve the organization and its business practices to better meet customer needs and believes that it is well positioned to respond to the evolving health care environment and market forces.

Government Regulation

The pharmaceutical industry is subject to regulation by regional, country, state and local agencies around the world. Governmental regulation and legislation tend to focus on standards and processes for determining drug safety and effectiveness, as well as conditions for sale or reimbursement, especially related to the pricing of products.

Of particular importance is the FDA in the United States, which administers requirements covering the testing, approval, safety, effectiveness, manufacturing, labeling, and marketing of prescription pharmaceuticals. In many cases, the FDA requirements and practices have increased the amount of time and resources necessary to develop new products and bring them to market in the United States.

The EU has adopted directives and other legislation concerning the classification, labeling, advertising, wholesale distribution, integrity of the supply chain, enhanced pharmacovigilance monitoring and approval for marketing of medicinal products for human use. These provide mandatory standards throughout the EU, which may be supplemented or implemented with additional regulations by the EU member states. The Company's policies and procedures are already consistent with the substance of these directives; consequently, it is believed that they will not have any material effect on the Company's business.

The Company believes that it will continue to be able to conduct its operations, including launching new drugs, in this regulatory environment.

Access to Medicines

As a global health care company, Merck's primary role is to discover and develop innovative medicines and vaccines. The Company also recognizes that it has an important role to play in helping to improve access to its products around the world. The Company's efforts in this regard are wide-ranging and include a set of principles that the Company strives to embed into its operations and business strategies to guide the Company's worldwide approach to expanding access to health care. For example, the Company has been recognized for pricing many of its products through a differential pricing framework, taking into consideration such factors as a country's level of economic development and public health need. In addition, the Merck Patient Assistance Program provides medicines and adult vaccines for free to people in the United States who do not have prescription drug or health insurance coverage and who, without the Company's assistance, cannot afford their Merck medicine and vaccines.

Building on the Company's own efforts, Merck has undertaken collaborations with many stakeholders to improve access to medicines and enhance the quality of life for people around the world.

For example, in 2011, Merck announced that it would launch "Merck for Mothers," a long-term effort with global health partners to create a world where no woman has to die from preventable complications of pregnancy and childbirth. The launch includes a 10-year, $500 million initiative that applies Merck's scientific and business expertise to making proven solutions more widely available, developing new technologies and improving public awareness, policy efforts and private sector engagement to reduce maternal mortality.

Merck has also in the past provided funds to the Merck Foundation, an independent organization, which has partnered with a variety of organizations dedicated to improving global health. One of these partnerships is The African Comprehensive HIV/AIDS Partnership in Botswana, a collaboration with the government of Botswana that was renewed in 2010 and supports Botswana's response to HIV/AIDS through a comprehensive and sustainable approach to HIV prevention, care, treatment, and support.

Privacy and Data Protection

The Company is subject to a number of privacy and data protection laws and regulations globally. The legislative and regulatory landscape for privacy and data protection continues to evolve. There has been increased attention to privacy and data protection issues in both developed and emerging markets with the potential to affect directly the Company's business, including recently enacted laws and regulations in the United States, Europe, Asia and Latin America and increased enforcement activity in the United States and other developed markets.

Operating Results

Sales

Worldwide sales totaled $47.3 billion in 2012, a decline of 2% compared with $48.0 billion in 2011. Foreign exchange unfavorably affected global sales performance by 3%. The sales decrease was driven primarily by *Singulair*, which lost market exclusivity in the United States in August 2012 resulting in a significant and rapid decline in U.S. *Singulair* sales. The sales decline was also driven by lower sales of *Remicade*, a treatment for inflammatory diseases, largely as a result of the arbitration settlement agreement with J&J in 2011 as discussed below. In addition, lower sales of *Cozaar* and *Hyzaar*, treatments for hypertension, *Clarinex*, a non-sedating antihistamine, *Fosamax*, for the treatment of osteoporosis, *Vytorin*, a cholesterol modifying medicine, *Primaxin*, an anti-bacterial product, and *Avelox*, a broad-spectrum fluoroquinolone antibiotic for the treatment of certain respiratory and skin infections, as well as lower revenue from the Company's relationship with AstraZeneca LP ("AZLP") also contributed to the sales decline in 2012. These declines were largely offset by higher sales of *Januvia*, *Gardasil*, *Victrelis*, *Zostavax*, *Janumet*, *Isentress*, *Zetia*, a cholesterol modifying medicine, *Dulera*, a combination medicine for the treatment of asthma, as well as by higher sales of the Company's animal health and consumer care products.

Sales in the United States were $20.4 billion in 2012, a decline of 1% compared with $20.5 billion in 2011. The sales decrease was driven by lower sales of *Singulair*, *Vytorin*, *Avelox*, *Cozaar* and *Hyzaar*, as well as lower revenue from the Company's relationship with AZLP. These declines were largely offset by higher sales of

Januvia, *Zostavax*, *Gardasil*, *Victrelis*, *Janumet*, *Isentress*, *Pneumovax*, a vaccine to help prevent pneumococcal disease, *Zetia* and *Dulera*, as well as higher sales of animal health and consumer care products.

International sales were $26.9 billion in 2012, a decline of 2% compared with $27.6 billion in 2011. Foreign exchange unfavorably affected international sales performance by 4% in 2012. Declines in Europe and Canada were partially offset by growth in Japan and certain of the emerging markets, particularly in China. Lower sales of *Remicade* led the decline, along with lower sales of *Cozaar*, *Hyzaar*, *Singulair*, *Fosamax* and *Clarinex*, partially offset by growth in *Januvia*, *Victrelis*, *Gardasil* and *Janumet*. International sales represented 57% of total sales in both 2012 and 2011.

Global efforts toward health care cost containment continue to exert pressure on product pricing and market access worldwide. In many international markets, government-mandated pricing actions have reduced prices of generic and patented drugs. In addition, other austerity measures negatively affected the Company's revenue performance in 2012. The Company anticipates these pricing actions and other austerity measures will continue to negatively affect revenue performance in 2013.

Worldwide sales totaled $48.0 billion in 2011, an increase of 4% compared with $46.0 billion in 2010. Foreign exchange favorably affected global sales performance by 2%. The revenue increase was driven largely by growth in *Januvia* and *Janumet, Singulair*, *Isentress, Gardasil, Simponi, RotaTeq*, a vaccine to help protect against rotavirus gastroenteritis in infants and children, *Zetia*, *Pneumovax* and *Bridion*, for the reversal of certain muscle relaxants used during surgery. In addition, revenue in 2011 benefited from higher sales of the Company's animal health products and from the launch of *Victrelis*. These increases were partially offset by lower sales of *Cozaar*, *Hyzaar*, *Vytorin*, *Temodar*, a treatment for certain types of brain tumors, *ProQuad*, a pediatric combination vaccine to help protect against measles, mumps, rubella and varicella, and *Varivax*, a vaccine to help prevent chickenpox (varicella). Revenue was also negatively affected by lower sales of Caelyx, Subutex and Suboxone as the Company no longer has marketing rights to these products. In addition, the ongoing implementation of certain provisions of U.S. health care reform legislation during 2011 resulted in further increases in Medicaid rebates and other impacts that reduced revenues as compared with 2010.

Sales of the Company's products were as follows:

($ in millions)	**2012**	2011	2010
Primary Care and Women's Health			
Cardiovascular			
Zetia	**$ 2,567**	$ 2,428	$ 2,297
Vytorin	**1,747**	1,882	2,014
Diabetes and Obesity			
Januvia	**4,086**	3,324	2,385
Janumet	**1,659**	1,363	954
Respiratory			
Singulair	**3,853**	5,479	4,987
Nasonex	**1,268**	1,286	1,219
Clarinex	**393**	621	623
Dulera	**207**	96	8
Asmanex	**185**	206	208
Women's Health and Endocrine			
Fosamax	**676**	855	926
NuvaRing	**623**	623	559
Follistim AQ	**468**	530	528
Implanon	**348**	294	236
Cerazette	**271**	268	209
Other			
Maxalt	**638**	639	550
Arcoxia	**453**	431	398
Avelox	**201**	322	316
Hospital and Specialty			
Immunology			
Remicade	**2,076**	2,667	2,714
Simponi	**331**	264	97
Infectious Disease			
Isentress	**1,515**	1,359	1,090
PegIntron	**653**	657	737
Cancidas	**619**	640	611
Victrelis	**502**	140	—
Invanz	**445**	406	362
Primaxin	**384**	515	610
Noxafil	**258**	230	198
Oncology			
Temodar	**917**	935	1,065
Emend	**489**	419	378
Other			
Cosopt/Trusopt	**444**	477	484
Bridion	**261**	201	103
Integrilin	**211**	230	266
Diversified Brands			
Cozaar/Hyzaar	**1,284**	1,663	2,104
Propecia	**424**	447	447
Zocor	**383**	456	468
Claritin Rx	**244**	314	296
Remeron	**232**	241	223
Proscar	**217**	223	216
Vasotec/Vaseretic	**192**	231	255
Vaccines(1)			
Gardasil	**1,631**	1,209	988
ProQuad/M-M-R II/Varivax	**1,273**	1,202	1,378
Zostavax	**651**	332	243
RotaTeq	**601**	651	519
Pneumovax	**580**	498	376
Other pharmaceutical(2)	**4,141**	4,035	4,622
Total Pharmaceutical segment sales	**40,601**	41,289	39,267
Other segment sales(3)	**6,412**	6,428	6,159
Total segment sales	**47,013**	47,717	45,426
Other(4)	**254**	330	561
	$47,267	$48,047	$45,987

(1) *These amounts do not reflect sales of vaccines sold in most major European markets through the Company's joint venture, Sanofi Pasteur MSD, the results of which are reflected in* Equity income from affiliates. *These amounts do, however, reflect supply sales to Sanofi Pasteur MSD.*

(2) *Other pharmaceutical primarily reflects sales of other human health pharmaceutical products, including products within the franchises not listed separately.*

(3) *Represents the non-reportable segments of Animal Health, Consumer Care and Alliances. The Alliances segment includes revenue from the Company's relationship with AZLP.*

(4) *Other revenues are primarily comprised of miscellaneous corporate revenues, third-party manufacturing sales, sales related to divested products or businesses and other supply sales not included in segment results.*

Pharmaceutical Segment

Primary Care and Women's Health

Cardiovascular

Worldwide sales of *Zetia* (also marketed as *Ezetrol* outside the United States), a cholesterol absorption inhibitor, increased 6% in 2012 to $2.6 billion, including a 2% unfavorable effect from foreign exchange. The sales increase reflects positive performance in the United States due to pricing, as well as volume growth in Japan, partially offset by volume declines in the United States. Sales of *Zetia* increased 6% in 2011 to $2.4 billion, including a 3% favorable effect from foreign exchange. The increase reflects higher sales in international markets, particularly in Japan, partially offset by volume declines in the United States.

Global sales of *Vytorin* (marketed outside the United States as *Inegy*), a combination product containing the active ingredients of both *Zetia* and *Zocor*, declined 7% in 2012 to $1.7 billion, including a 3% unfavorable effect from foreign exchange. The sales decline reflects volume declines in the United States, partially offset by pricing in the United States and volume growth in certain international markets. Worldwide sales of *Vytorin* declined 7% in 2011 to $1.9 billion reflecting volume declines in the United States, partially offset by increases in international markets.

In March 2012, the Data Safety Monitoring Board (the "DSMB") of the IMPROVE-IT trial, a large cardiovascular outcomes study evaluating ezetimibe/simvastatin against simvastatin alone in patients presenting with acute coronary syndrome, completed the second pre-specified interim efficacy analysis of the study. The DSMB conducted the planned interim efficacy analysis after the trial had reached approximately 75% of the targeted 5,250 clinical endpoints called for in the study design. The DSMB recommended that the study continue without change in design and stated it planned to review the data again in approximately nine months. That review has been scheduled for March 2013, at which point nine months of additional data will have been adjudicated. Merck remains blinded to IMPROVE-IT safety and efficacy data. IMPROVE-IT is an 18,000 patient event-driven trial and, based on the current rate at which events are being reported, the Company now anticipates the targeted 5,250 clinical endpoints for study completion will be reached in 2014.

In December 2012, Merck announced the HPS2-THRIVE study of *Tredaptive* did not meet its primary endpoint (see "Research and Development" below). Subsequently, based on the understanding of the preliminary data from the HPS2-THRIVE study and in consultation with regulatory authorities, Merck began taking steps to suspend the availability of *Tredaptive*, which is approved for use in certain countries outside of the United States. The Company recognized approximately $40 million of costs in 2012 associated with suspending the availability of *Tredaptive*. Sales of *Tredaptive* were $17 million in 2012.

Diabetes and Obesity

Global sales of *Januvia*, Merck's dipeptidyl peptidase-4 ("DPP-4") inhibitor for the treatment of type 2 diabetes, rose 23% in 2012 to $4.1 billion and grew 39% in 2011 to $3.3 billion reflecting volume growth in the United States, as well as in international markets, particularly in Japan. Foreign exchange unfavorably affected sales performance by 2% in 2012 and favorably affected sales performance by 3% in 2011.

Worldwide sales of *Janumet*, Merck's oral antihyperglycemic agent that combines sitagliptin (*Januvia)* with metformin in a single tablet to target all three key defects of type 2 diabetes, were $1.7 billion in 2012, an increase of 22% compared with 2011, reflecting volume growth in the United States, the emerging markets and Europe. Global sales of *Janumet* were $1.4 billion in 2011 compared with $954 million in 2010 reflecting growth internationally due in part to ongoing launches in certain markets, as well as growth in the United States. Foreign exchange unfavorably affected sales performance by 4% in 2012 and favorably affected sales performance by 2% in 2011.

In February 2012, the FDA approved *Janumet XR*, a new treatment for type 2 diabetes that combines sitagliptin with extended-release metformin. *Janumet XR* provides a convenient once-daily treatment option for health care providers and patients who need help to control their blood sugar.

As previously disclosed, on February 17, 2012, the FDA sent a Warning Letter to the Company relating to *Januvia* and *Janumet* stating that the Company did not fulfill a post-marketing requirement for a 3-month pancreatic safety study in a diabetic rodent model treated with sitagliptin. The Company completed the study and submitted the study report to the FDA in December 2012. The FDA has recently reviewed the submission and concluded that the post-marketing requirement has been fulfilled.

Respiratory

Worldwide sales of *Singulair,* a once-a-day oral medicine for the chronic treatment of asthma and for the relief of symptoms of allergic rhinitis, declined 30% to $3.9 billion in 2012 driven primarily by lower sales in the United States. Revenue declines in Europe, Canada and Latin America also contributed to the *Singulair* sales decline. The patent that provided U.S. market exclusivity for *Singulair* expired on August 3, 2012 and the Company experienced a significant and rapid decline in U.S. *Singulair* sales thereafter. U.S. sales of *Singulair* declined 97% in the fourth quarter to $25 million. U.S. sales of *Singulair* decreased 39% to $2.2 billion for the full year of 2012 driven by lower sales after the U.S. patent expiry in August. In addition, the patent that provided market exclusivity for *Singulair* expired in a number of major European markets in February 2013 and the Company expects a significant and rapid reduction in sales of *Singulair* in those markets. The patent that provides market exclusivity for *Singulair* in Japan will expire in 2016. In 2012, sales of *Singulair* were $602 million in Europe and $668 million in Japan. Global sales of *Singulair* grew 10% in 2011 to $5.5 billion, including a 2% favorable impact of foreign exchange, driven primarily by favorable pricing in the United States, as well as volume growth in Japan and in the emerging markets.

Global sales of *Nasonex*, an inhaled nasal corticosteroid for the treatment of nasal allergy symptoms, declined 1% in 2012 to $1.3 billion, including a 1% unfavorable impact from foreign exchange. Sales performance reflects price declines in Europe and lower volumes in the United States, largely offset by higher prices in the United States. In 2009, Apotex Inc. and Apotex Corp. (collectively, "Apotex") filed an Abbreviated New Drug Application with the FDA seeking approval to sell its generic version of *Nasonex*. In June 2012, the U.S. District Court for the District of New Jersey ruled against the Company in a patent infringement suit against Apotex holding that Apotex's generic version of *Nasonex* does not infringe on the Company's formulation patent (see Note 11 to the consolidated financial statements). The Company has appealed the U.S. District Court decision. If generic versions become available, significant losses of *Nasonex* sales could occur and the Company may take a non-cash impairment charge with respect to the value of the *Nasonex* intangible asset, which had a carrying value of approximately $1.9 billion at December 31, 2012. If the *Nasonex* intangible asset is determined to be impaired, the impairment charge could be material. As a result of the unfavorable U.S. District Court decision, the Company evaluated the *Nasonex* intangible asset for impairment and concluded that it was not impaired. U.S. sales of *Nasonex* were $597 million in 2012. Worldwide sales of *Nasonex* increased 5% in 2011 to $1.3 billion, including a 1% favorable effect from foreign exchange. The sales increase was driven largely by volume growth in Japan and Latin America, partially offset by volume declines in the United States.

Global sales of *Clarinex* (marketed as *Aerius* in many countries outside the United States), a non-sedating antihistamine, declined 37% in 2012 to $393 million driven by lower volumes in Europe and the United States as a result of generic competition. As previously disclosed, by virtue of litigation settlements, certain generic manufacturers were given the right to enter the U.S. market in 2012 and several generic versions have been launched. The Company anticipates that sales of *Clarinex* will continue to decline. Worldwide sales of *Clarinex* were $621 million in 2011 compared with $623 million in 2010.

Global sales of *Dulera* Inhalation Aerosol, a combination medicine for the treatment of asthma, were $207 million in 2012 compared with $96 million in 2011 reflecting volume growth in the United States. *Dulera* Inhalation Aerosol was approved by the FDA in June 2010. In January 2012, Merck received a Complete Response Letter from the FDA on the Company's supplemental New Drug Application for *Dulera*, for the treatment of chronic obstructive pulmonary disease. The Company is planning to conduct an additional clinical study and update the application in the future.

Women's Health and Endocrine

Worldwide sales of *Fosamax* and *Fosamax Plus D* (marketed as *Fosavance* throughout the EU and as *Fosamac* in Japan) for the treatment and, in the case of *Fosamax*, prevention of osteoporosis, declined 21% in 2012 to $676 million and decreased 8% in 2011 to $855 million. These medicines have lost market exclusivity in the United States and in most major European markets. During 2012, declines in Japan and the emerging markets also contributed to the sales decrease. The Company expects the declines within the *Fosamax* product franchise to continue.

Worldwide sales of *NuvaRing*, a vaginal contraceptive product, were $623 million in 2012, comparable with sales in 2011. Foreign exchange unfavorably affected sales performance by 3% in 2012. Excluding the unfavorable impact of foreign exchange, sales performance in 2012 reflects volume growth in the emerging markets and positive performance in Europe. Global sales of *NuvaRing* grew 12% to $623 million in 2011, including a 3% beneficial effect from foreign exchange, driven by positive performance in the United States and internationally.

Global sales of *Follistim AQ* (marketed in most countries outside the United States as *Puregon*), a biological fertility treatment, declined 12% in 2012 to $468 million, including a 3% unfavorable effect from foreign exchange, driven largely by declines in Europe resulting from supply issues and pricing. Sales of *Follistim AQ* were $530 million in 2011 compared with $528 million in 2010 reflecting growth in emerging markets offset by declines in Europe due primarily to supply constraints. *Puregon* lost market exclusivity in the EU in August 2009.

The Company is currently experiencing difficulty manufacturing certain women's health products. The Company is working to resolve these issues, which were not material to the Company's results of operations.

Other

Global sales of *Maxalt*, a product for the acute treatment of migraine, were $638 million in 2012, comparable with sales in 2011. Sales performance in 2012 reflects higher sales in the United States driven by favorable pricing, offset by volume declines in Europe and Canada due to generic erosion. Sales of *Maxalt* increased 16% in 2011 to $639 million reflecting a higher inventory level and favorable pricing in the United States. The patent that provided U.S. market exclusivity for *Maxalt* expired in December 2012 and the Company is experiencing a decline in U.S. *Maxalt* sales and expects the decline to continue. In addition, the patent that provides market exclusivity for *Maxalt* will expire in a number of major European markets in August 2013 and the Company anticipates that sales in those European markets will decline significantly after these patent expiries. In 2012, sales of *Maxalt* were $491 million in the United States and $92 million in Europe.

Sales of *Avelox*, a broad-spectrum fluoroquinolone antibiotic for the treatment of certain respiratory and skin infections marketed by the Company in the United States, declined 37% in 2012 to $201 million due primarily to a competitor's product becoming available in generic form. Sales of *Avelox* grew 2% in 2011 to $322 million. The patent that provides U.S. market exclusivity for *Avelox* expires in March 2014; however, by agreement, a generic manufacturer may launch a generic version of *Avelox* in February 2014.

Other products included in Primary Care and Women's Health include among others, *Asmanex Twisthaler*, an inhaled corticosteroid for asthma; *Implanon*, a single-rod subdermal contraceptive implant; *Cerazette*, a progestin only oral contraceptive; and *Arcoxia*, for the treatment of arthritis and pain.

Hospital and Specialty

Immunology

Sales of *Remicade,* a treatment for inflammatory diseases, were $2.1 billion in 2012, a decline of 22% compared with 2011, and were $2.7 billion in 2011, a decline of 2% compared with 2010. Foreign exchange unfavorably affected global sales performance by 6% in 2012 and favorably affected sales performance by 5% in 2011. Prior to July 1, 2011, *Remicade* was marketed by the Company outside of the United States (except in Japan and certain other Asian markets). As a result of the agreement reached in April 2011 to amend the agreement governing the distribution rights to *Remicade* and *Simponi*, effective July 1, 2011, Merck relinquished marketing rights for these products in certain territories including Canada, Central and South America, the Middle East, Africa and Asia Pacific. Merck retained exclusive marketing rights throughout Europe, Russia and Turkey (the "Retained Territories"). In the Retained Territories, *Remicade* sales declined 2% in 2012, which reflects an 8% unfavorable effect from foreign exchange and volume growth in Europe. Sales of *Remicade* in the Retained Territories grew 13% in 2011, which reflects a 6% favorable impact from foreign exchange. *Simponi*, a once-monthly subcutaneous treatment for certain inflammatory diseases was approved by the European Commission (the "EC") in October 2009. Sales of *Simponi* were $331 million in 2012, $264 million in 2011 and $97 million in 2010. The revenue increases were driven by growth in the Retained Territories due in part to ongoing launches. In July 2012, a submission was made to the European Medicines Agency (the "EMA") requesting approval of *Simponi* for the treatment of adult patients with moderately to severely active ulcerative colitis who have had an inadequate response to conventional therapy.

Infectious Disease

Worldwide sales of *Isentress,* an HIV integrase inhibitor for use in combination with other antiretroviral agents for the treatment of HIV-1 infection, grew 11% in 2012 to $1.5 billion driven primarily by volume growth in the United States, Latin America and the Asia Pacific region. Global sales of *Isentress* rose 25% in 2011 to $1.4 billion reflecting volume growth in the United States and internationally, partially offset by unfavorable pricing in European markets. Foreign exchange unfavorably affected global sales performance by 4% in 2012 and favorably affected sales performance by 3% in 2011.

Worldwide sales of *PegIntron*, a treatment for chronic hepatitis C, declined 1% in 2012 to $653 million, including an unfavorable effect from foreign exchange of 4%. Excluding the unfavorable impact of foreign exchange, sales performance reflects volume growth and favorable pricing in the United States and volume growth in certain of the emerging markets. Sales of *PegIntron* declined 11% in 2011 to $657 million, including a 4% favorable effect from foreign exchange, reflecting competitive pressures.

Global sales of *Cancidas*, an anti-fungal product, declined 3% in 2012 to $619 million, including a 5% unfavorable effect from foreign exchange. Excluding the unfavorable impact of foreign exchange, sales performance in 2012 reflects growth in the emerging markets. Sales of *Cancidas* grew 5% in 2011 to $640 million, including a 4% favorable effect from foreign exchange, reflecting higher sales in Europe and Canada, partially offset by declines in the United States.

Global sales of *Victrelis*, the Company's innovative oral medicine for the treatment of chronic hepatitis C, were $502 million in 2012 compared with $140 million in 2011, driven by post-launch growth in the United States and internationally, particularly in Europe. *Victrelis* was approved by the FDA in May 2011 and by the EC in July 2011. *Victrelis* is approved in 70 countries and has launched in 45 of those markets.

Sales of *Primaxin*, an anti-bacterial product, declined 25% in 2012 to $384 million and decreased 16% in 2011 to $515 million. Patents on *Primaxin* have expired worldwide and multiple generics have been launched.

Oncology

Sales of *Temodar* (marketed as *Temodal* outside the United States), a treatment for certain types of brain tumors, declined 2% in 2012 to $917 million, including a 2% unfavorable effect from foreign exchange. Sales declines in Europe from generic competition were offset by price increases in the United States. Sales of *Temodar* decreased 12% in 2011 to $935 million, including a 3% favorable effect from foreign exchange, primarily reflecting generic competition in Europe. *Temodar* lost patent exclusivity in the EU in 2009. As previously disclosed, by agreement, a generic manufacturer may launch a generic version of *Temodar* in the United States in August 2013. Accordingly, the Company anticipates U.S. sales of *Temodar*, which were $423 million in 2012, will decline significantly in 2013. The U.S. patent and exclusivity periods will otherwise expire in February 2014.

Global sales of *Emend*, for the prevention of chemotherapy-induced and post-operative nausea and vomiting, increased 17% in 2012 to $489 million, including a 2% unfavorable effect from foreign exchange. The sales increase reflects volume growth in the United States and Japan. Sales of *Emend* increased 11% in 2011 to $419 million primarily reflecting growth in international markets.

Other

Worldwide sales of ophthalmic products *Cosopt* and *Trusopt* declined 7% in 2012 to $444 million, including a 4% unfavorable effect from foreign exchange. The sales decline primarily reflects lower sales in Europe due to generic erosion and price reductions, mitigated in part by higher *Cosopt* sales in Japan. Sales of *Cosopt* and *Trusopt* declined 1% in 2011 to $477 million, including a 5% favorable impact of foreign exchange, reflecting unfavorable pricing and volume declines in Europe, partially offset by higher *Cosopt* sales in Japan. The patent that provided U.S. market exclusivity for *Cosopt* and *Trusopt* has expired. *Trusopt* has also lost market exclusivity in a number of major European markets. The patent for *Cosopt* will expire in a number of major European markets in March 2013 and the Company expects sales in those markets to decline significantly thereafter.

Bridion (sugammadex sodium injection), for the reversal of certain muscle relaxants used during surgery, is approved and has been launched in many countries outside of the United States. Sales of *Bridion* were $261 million in 2012, $201 million in 2011 and $103 million in 2010. Sugammadex sodium injection is currently under review by the FDA.

In 2009, the FDA approved *Saphris* (asenapine), an antipsychotic indicated for the treatment of schizophrenia and bipolar I disorder in adults. In 2010, asenapine, sold under the brand name *Sycrest*, received marketing approval in the EU for the treatment of bipolar I disorder in adults. In 2010, Merck and H. Lundbeck A/S ("Lundbeck") announced a worldwide commercialization agreement for *Sycrest* sublingual tablets (5 mg, 10 mg). Under the terms of the agreement, Lundbeck paid a fee and makes product supply payments in exchange for exclusive commercial rights to *Sycrest* in all markets outside the United States, China and Japan. Merck's sales of *Saphris* were $166 million in 2012 and $120 million in 2011. Merck continues to focus on building and maintaining the brand awareness of *Saphris* in the United States. If these efforts in the United States or Lundbeck's on-going launch of the product in the EU are not successful, the Company may take a non-cash impairment charge with respect to the value of the *Saphris/Sycrest* intangible asset, which had a carrying value of approximately $550 million at December 31, 2012. If the *Saphris/Sycrest* intangible asset is determined to be impaired, the impairment charge could be material.

Other products contained in Hospital and Specialty include among others, *Invanz*, for the treatment of certain infections; *Noxafil*, for the prevention of certain invasive fungal infections; and Integrilin, a treatment for patients with acute coronary syndrome, which is sold by the Company in the United States and Canada.

Diversified Brands

Merck's diversified brands include human health pharmaceutical products that are approaching the expiration of their marketing exclusivity or are no longer protected by patents in developed markets, but continue to be a core part of the Company's offering in other markets around the world.

Global sales of *Cozaar* and its companion agent *Hyzaar* (a combination of *Cozaar* and hydrochlorothiazide), treatments for hypertension, declined 23% in 2012 to $1.3 billion and decreased 21% in 2011 to $1.7 billion. The patents that provided market exclusivity for *Cozaar* and *Hyzaar* in the United States and in a number of major international markets have expired. Accordingly, the Company is experiencing significant declines in *Cozaar* and *Hyzaar* sales and the Company expects the declines to continue.

Other products contained in Diversified Brands include among others, *Propecia*, a product for the treatment of male pattern hair loss; *Zocor*, a statin for modifying cholesterol; prescription *Claritin*, a treatment for seasonal outdoor allergies and year-round indoor allergies; *Remeron*, an antidepressant; *Proscar,* a urology product for the treatment of symptomatic benign prostate enlargement; and *Vasotec* and *Vaseretic*, hypertension and/or heart failure products. The formulation/use patent that provides U.S. market exclusivity for *Propecia* expires in October 2013; however, as previously disclosed, by agreement, one generic manufacturer entered the U.S. market in January 2013 and another has been given the right to enter in July 2013. Accordingly, the Company anticipates U.S. sales of *Propecia*, which were $124 million in 2012, will decline significantly in 2013.

Vaccines

The following discussion of vaccines does not include sales of vaccines sold in most major European markets through Sanofi Pasteur MSD ("SPMSD"), the Company's joint venture with Sanofi Pasteur, the results of which are reflected in *Equity income from affiliates* (see "Selected Joint Venture and Affiliate Information" below). Supply sales to SPMSD, however, are included.

Worldwide sales of *Gardasil* recorded by Merck grew 35% in 2012 to $1.6 billion driven primarily by growth in the United States, reflecting continued uptake in males and approximately $45 million of government purchases for the U.S. Centers for Disease Control and Prevention (the "CDC") Pediatric Vaccine Stockpile, as well as growth in the emerging markets, particularly in Latin America and the Asia Pacific region, and in Japan. Sales of *Gardasil* rose 22% in 2011 to $1.2 billion driven by greater uptake in males in the United States, higher sales in conjunction with the launch in Japan and growth in emerging markets, partially offset by lower government orders in Canada. *Gardasil,* the world's top-selling HPV vaccine, is indicated for girls and women 9 through 26 years of age for the prevention of cervical, vulvar, vaginal and anal cancer caused by HPV types 16 and 18, certain precancerous or dysplastic lesions caused by HPV types 6, 11, 16 and 18, and genital warts caused by HPV types 6 and 11. *Gardasil* is also approved in the United States for use in boys and men 9 through 26 years of age for the prevention of anal cancer caused by HPV types 16 and 18, anal dysplasias and precancerous lesions caused by HPV types 6, 11, 16 and 18, and genital warts caused by HPV types 6 and 11. The Company is a party to certain third-party license agreements with respect to *Gardasil* (including a cross-license and settlement agreement with GlaxoSmithKline). As a result of these agreements, the Company pays royalties on worldwide *Gardasil* sales of 21% to 27% which vary by country and are included in *Materials and production* costs.

In recent years, the Company has experienced difficulties in producing its varicella zoster virus ("VZV")-containing vaccines. These difficulties have resulted in supply constraints for *ProQuad*, *Varivax* and *Zostavax*. The Company has resolved the supply constraints in the United States and anticipates limited launches in international markets for *Zostavax* in 2013 as noted below.

ProQuad, a pediatric combination vaccine to help protect against measles, mumps, rubella and varicella, one of the VZV-containing vaccines, became available again in the United States for ordering in October 2012. Merck's sales of *ProQuad* were $61 million in 2012, $34 million in 2011 and $134 million in 2010. Sales in all of these years were affected by supply constraints.

Merck's sales of *Varivax,* a vaccine to help prevent chickenpox (varicella), were $846 million in 2012, $831 million in 2011 and $929 million in 2010. Sales for 2010 reflect $48 million of government purchases for the CDC's Pediatric Vaccine Stockpile. Merck's sales of *M-M-R* II, a vaccine to help protect against measles, mumps and rubella, were $365 million in 2012, $337 million in 2011 and $315 million in 2010. Sales growth in 2012 was driven primarily by higher volumes in the United States. Sales of *Varivax* and *M-M-R* II were affected by *ProQuad* supply constraints discussed above.

Merck's sales of *Zostavax,* a vaccine to help prevent shingles (herpes zoster) in adults 50 years of age and older, were $651 million in 2012, $332 million in 2011 and $243 million in 2010. Sales performance in 2012 reflects supply availability and increased promotional efforts in the United States. Sales in 2011 and 2010 were affected by supply issues. The Company anticipates limited launches outside of the United States later in 2013.

Merck's sales of *RotaTeq,* a vaccine to help protect against rotavirus gastroenteritis in infants and children, declined 8% in 2012 to $601 million reflecting favorable public sector inventory fluctuations in 2011, partially offset by volume growth in the emerging markets and Japan in 2012. Merck's sales of *RotaTeq* grew 25% in 2011 to $651 million reflecting favorable public sector inventory fluctuations and growth in emerging markets.

Merck's sales of *Pneumovax*, a vaccine to help prevent pneumococcal disease, grew 17% in 2012 to $580 million due primarily to growth in the United States as a result of price increases and higher volumes, partially offset by declines in Japan. Sales of *Pneumovax* increased 33% in 2011 to $498 million due to positive performance in the United States, due in part to favorable pricing, and growth in Japan.

Merck's adult formulation of *Vaqta*, a vaccine against hepatitis A which was experiencing supply issues, became available in the third quarter of 2012.

Other Segments

Animal Health

Animal Health includes pharmaceutical and vaccine products for the prevention, treatment and control of disease in all major farm and companion animal species. Animal Health sales are affected by intense competition and the frequent introduction of generic products. Global sales of Animal Health products grew 4% in 2012 to $3.4 billion and increased 11% in 2011 to $3.3 billion. Foreign exchange unfavorably affected global sales performance by 5% in 2012 and favorably affected global sales performance by 4% in 2011. The increase in sales in both periods was driven by positive performance among cattle, poultry, companion animal and swine products.

Consumer Care

Consumer Care products include over-the-counter, foot care and sun care products such as *Claritin* non-drowsy antihistamines; *MiraLAX*, for the relief of occasional constipation; *Dr. Scholl's* foot care products; and *Coppertone* sun care products. Global sales of Consumer Care products grew 6% in 2012, including a 1% unfavorable effect from foreign exchange, to $2.0 billion reflecting higher sales of *Dr. Scholl's*, *Coppertone*, *MiraLAX* and *Claritin*, partially offset by lower sales of *Marvelon*, an oral contraceptive, which is an over-the-counter product in China. Sales increased 1% in 2011 to $1.8 billion reflecting strong performance of *Coppertone*, offset by declines in *Dr. Scholl's* and *Claritin*. Consumer Care product sales are affected by competition and consumer spending patterns. In January 2013, the FDA approved *Oxytrol for Women*, the first and only over-the-counter treatment for overactive bladder in women, which the Company anticipates will be available to customers in fall 2013.

Alliances

The alliances segment includes results from the Company's relationship with AZLP. Revenue from AZLP, primarily relating to sales of Nexium and Prilosec, was $915 million in 2012, $1.2 billion in 2011 and $1.3 billion in 2010. AstraZeneca has an option to buy Merck's interest in a subsidiary, and through it, Merck's interest in Nexium and Prilosec, exercisable in 2014, and the Company believes that it is likely that AstraZeneca will exercise that option (see "Selected Joint Venture and Affiliate Information" below). If AstraZeneca exercises its option, the Company will no longer record equity income from AZLP and supply sales to AZLP will decline substantially.

Costs, Expenses and Other

($ in millions)	**2012**	**Change**	2011	Change	2010
Materials and production	**$16,446**	**-3%**	$16,871	-8%	$18,396
Marketing and administrative	**12,776**	**-7%**	13,733	5%	13,125
Research and development[(1)]	**8,168**	**-4%**	8,467	-24%	11,111
Restructuring costs	**664**	**-49%**	1,306	33%	985
Equity income from affiliates	**(642)**	**5%**	(610)	4%	(587)
Other (income) expense, net	**1,116**	**18%**	946	-27%	1,304
	$38,528	**-5%**	$40,713	-8%	$44,334

[(1)] *Includes $200 million, $587 million and $2.4 billion of IPR&D impairment charges in 2012, 2011 and 2010, respectively.*

Materials and Production

Materials and production costs were $16.4 billion in 2012, $16.9 billion in 2011 and $18.4 billion in 2010. Costs include expenses for the amortization of intangible assets recorded in connection with mergers and acquisitions which totaled $4.9 billion in each of 2012 and 2011 and $4.6 billion in 2010. Additionally, expenses in 2011 and 2010 include $89 million and $2.0 billion, respectively, of amortization of purchase accounting adjustments to Schering-Plough's inventories recognized as a result of the Merger. Costs in 2011 include an intangible asset impairment charge of $118 million. The Company may recognize additional non-cash impairment charges in the future related to product intangibles that were measured at fair value and capitalized in connection with mergers and acquisitions and such charges could be material. Also included in materials and production were costs associated with restructuring activities which amounted to $188 million, $348 million and $429 million in 2012, 2011 and 2010, respectively, including accelerated depreciation and asset write-offs related to the planned sale or closure of manufacturing facilities. Separation costs associated with manufacturing-related headcount reductions have been incurred and are reflected in *Restructuring costs* as discussed below.

Gross margin was 65.2% in 2012 compared with 64.9% in 2011 and 60.0% in 2010. The amortization of intangible assets and purchase accounting adjustments to inventories, as well as the restructuring and impairment charges noted above reduced gross margin by 10.7 percentage points in 2012, 11.4 percentage points in 2011 and 15.2 percentage points in 2010. Excluding these impacts, the gross margin decline in 2012 as compared with 2011 reflects the significant decline in *Singulair* sales as a result of the loss of U.S. market exclusivity, partially offset by improvements resulting from other changes in product mix. The Company anticipates that gross margin will continue to be negatively affected by the *Singulair* U.S. patent expiry which occurred in August 2012 and by the *Singulair* patent expiries in major European markets which occurred in February 2013. In addition, anticipated generic competition in the United States for *Maxalt* and *Propecia* will also negatively impact gross margin in 2013. The gross margin improvement in 2011 as compared with 2010 reflects changes in product mix and manufacturing efficiencies, as well as a benefit from foreign exchange.

Marketing and Administrative

Marketing and administrative expenses declined 7% in 2012 to $12.8 billion due to the favorable effect of foreign exchange, a decline in promotion costs and lower selling costs resulting from restructuring activities. Marketing and administrative expenses grew 5% to $13.7 billion in 2011 due in part to the unfavorable effect of foreign exchange and strategic investments made in emerging markets. Marketing and administrative expenses in 2012 and 2011 include $190 million and $162 million, respectively, of expenses for the annual health care reform fee required as part of U.S. health care reform legislation. Expenses for 2012, 2011 and 2010 include restructuring costs of $90 million, $119 million and $144 million, respectively, related primarily to accelerated depreciation for facilities to be closed or divested. Separation costs associated with sales force reductions have been incurred and are reflected in *Restructuring costs* as discussed below. Expenses also include $272 million, $278 million and $379 million of acquisition-related costs in 2012, 2011 and 2010, respectively, consisting of incremental, third-party integration costs related to the Merger, including costs related to legal entity and system integration. Acquisition-related costs for 2011 also consist of severance costs associated with the acquisition of Inspire Pharmaceuticals, Inc., which are not part of the Company's formal restructuring programs.

Research and Development

Research and development expenses were $8.2 billion in 2012, $8.5 billion in 2011 and $11.1 billion in 2010. Research and development expenses are comprised of the costs directly incurred by Merck Research Laboratories ("MRL"), the Company's research and development division that focuses on human health-related activities, which were approximately $4.5 billion in each of 2012 and 2011 and were $4.9 billion in 2010. Also included in research and development expenses are costs incurred by other divisions in support of research and development activities, including depreciation, production and general and administrative, as well as certain costs from operating segments, including the Pharmaceutical, Animal Health and Consumer Care segments, which in the aggregate were $3.4 billion, $3.2 billion and $3.4 billion for 2012, 2011 and 2010, respectively. Research and development expenses in 2012 and 2011 were favorably affected by cost savings resulting from restructuring activities. Included in research and development expenses in 2012 were upfront payments of approximately $260 million related to agreements with Endocyte and AiCuris. (See "Research and Development" below.)

Research and development expenses also include in-process research and development ("IPR&D") impairment charges and research and development-related restructuring charges. During 2012, the Company recorded $200 million of IPR&D impairment charges primarily for pipeline programs that had previously been deprioritized and were subsequently deemed to have no alternative use during the period. During 2011, the Company recorded IPR&D impairment charges of $587 million primarily for pipeline programs that were abandoned and determined to have no alternative use, as well as for expected delays in the launch timing or changes in the cash flow assumptions for certain compounds. In addition, the impairment charges related to pipeline programs that had previously been deprioritized and were either deemed to have no alternative use during the period or were out-licensed to a third party for consideration that was less than the related asset's carrying value. During 2010, the Company recorded $2.4 billion of IPR&D impairment charges. Of this amount, $1.7 billion related to the write-down of the intangible asset for vorapaxar resulting from developments in the clinical program for this compound. The remaining $763 million of IPR&D impairment charges recorded in 2010 were attributable to compounds that were abandoned and determined to have either no alternative use or were returned to the respective licensor, as well as from expected delays in the launch timing or changes in the cash flow assumptions for certain compounds. The Company may recognize additional non-cash impairment charges in the future for the cancellation or delay of other pipeline programs that were measured at fair value and capitalized in connection with mergers and acquisitions and such charges could be material. Research and development expenses in 2012, 2011 and 2010 reflect $57 million, $138 million and $428 million, respectively, of accelerated depreciation and asset abandonment costs associated with restructuring activities. In 2012, the Company recorded an adjustment to accelerated depreciation costs included in research and development expenses revising previously recorded amounts for certain facilities.

Share-Based Compensation

Total pretax share-based compensation expense was $335 million in 2012, $369 million in 2011 and $509 million in 2010. At December 31, 2012, there was $370 million of total pretax unrecognized compensation expense related to nonvested stock option, restricted stock unit and performance share unit awards which will be recognized over a weighted average period of 1.8 years. For segment reporting, share-based compensation costs are unallocated expenses.

Restructuring Costs

Restructuring costs were $664 million, $1.3 billion and $985 million in 2012, 2011 and 2010, respectively. Nearly all of the costs recorded in 2012 and 2011 relate to the Merger Restructuring Program. Of the restructuring costs recorded in 2010, $915 million related to the Merger Restructuring Program, $77 million related to the global restructuring program initiated in 2008 (the "2008 Restructuring Program") and the remaining activity related to the legacy Schering-Plough program, which included a gain on the sale of a manufacturing facility. In 2012, 2011 and 2010, separation costs of $489 million, $1.1 billion and $768 million, respectively, were incurred associated with actual headcount reductions, as well as estimated expenses under existing severance programs for headcount reductions that were probable and could be reasonably estimated. Merck eliminated approximately 4,255 positions in 2012 (of which 3,975 related to the Merger Restructuring Program, 155 related to the 2008 Restructuring Program and 125 related to the legacy Schering-Plough program), approximately 7,590 positions in 2011 (of which 6,880 related to the Merger Restructuring Program, 450 related to the 2008 Restructuring Program and 260 related to the legacy Schering-Plough program) and approximately 12,465 positions in 2010 (of which 11,410 related to the Merger Restructuring Program, 890 related to the 2008 Restructuring Program and 165 to the legacy Schering-Plough program). These position eliminations are comprised of actual headcount reductions, and the elimination of contractors and vacant positions. Also included in restructuring costs are curtailment, settlement and termination charges associated with pension and other postretirement benefit plans, share-based compensation plan costs, as well as contract termination and shutdown costs. For segment reporting, restructuring costs are unallocated expenses. Additional costs associated with the Company's restructuring activities are included in *Materials and production*, *Marketing and administrative* and *Research and development* as discussed above.

Equity Income from Affiliates

Equity income from affiliates, which reflects the performance of the Company's joint ventures and other equity method affiliates, increased 5% in 2012 to $642 million and grew 4% in 2011 to $610 million due primarily to higher partnership returns from AZLP. During 2011, the Company divested its interest in the Johnson & Johnson°Merck Consumer Pharmaceuticals Company ("JJMCP") joint venture. (See "Selected Joint Venture and Affiliate Information" below.)

Other (Income) Expense, Net

Other (income) expense, net was $1.1 billion of expense in 2012 compared with $946 million of expense in 2011 driven primarily by a $493 million net charge in 2012 relating to the settlement of the ENHANCE Litigation (see Note 11 to the consolidated financial statements) and gains recognized in 2011 of $136 million on the disposition of the Company's interest in the JJMCP joint venture (see Note 9 to the consolidated financial statements) and $127 million on the sale of certain manufacturing facilities and related assets (see Note 4 to the consolidated financial statements), partially offset by a $500 million charge in 2011 related to the resolution of the arbitration proceeding involving the Company's rights to market *Remicade* and *Simponi* (see Note 5 to the consolidated financial statements) and higher interest income in 2012. Other (income) expense, net in 2010 was $1.3 billion of expense reflecting a $950 million charge to settle certain litigation related to *Vioxx* (the "*Vioxx* Liability Reserve"), charges related to the settlement of certain pending AWP litigation, and $200 million of exchange losses due to two Venezuelan currency devaluations as discussed below, partially offset by $443 million of income recognized upon AstraZeneca's asset option exercise (see Note 9 to the consolidated financial statements) and $102 million of income recognized on the settlement of certain disputed royalties.

In February 2013, the Venezuelan government devalued its currency (Bolívar Fuertes) from 4.30 VEF per U.S. dollar to 6.30 VEF per U.S. dollar. The Company anticipates that it will recognize losses due to exchange of approximately $150 million in the first quarter of 2013 resulting from the remeasurement of the local monetary assets and liabilities at the new rate. Since January 2010, Venezuela has been designated hyperinflationary and, as a result, local foreign operations are remeasured in U.S. dollars with the impact recorded in results of operations. As noted above, exchange losses for 2010 reflect losses relating to Venezuelan currency devaluations. Effective January 11, 2010, the Venezuelan government devalued its currency to a two-tiered official exchange rate with an "essentials rate" and a "non-essentials rate." In December 2010, the Venezuelan government announced it would eliminate the essentials rate effective January 1, 2011. As a result of this announcement, the Company remeasured its December 31, 2010 monetary assets and liabilities at the new official rate.

Segment Profits

($ in millions)	**2012**	2011	2010
Pharmaceutical segment profits	**$ 25,852**	$ 25,617	$ 23,864
Other non-reportable segment profits	**3,163**	2,995	2,849
Other	**(20,276)**	(21,278)	(25,060)
Income before income taxes	**$ 8,739**	$ 7,334	$ 1,653

Segment profits are comprised of segment sales less standard costs, certain operating expenses directly incurred by the segment, components of equity income or loss from affiliates and depreciation and amortization expenses. For internal management reporting presented to the chief operating decision maker, Merck does not allocate materials and production costs, other than standard costs, the majority of research and development expenses or general and administrative expenses, nor the cost of financing these activities. Separate divisions maintain responsibility for monitoring and managing these costs, including depreciation related to fixed assets utilized by these divisions and, therefore, they are not included in segment profits. Also excluded from the determination of segment profits is the charge related to the settlement of the ENHANCE Litigation recorded in 2012, the arbitration settlement charge, the gain on the divestiture of the Company's interest in the JJMCP joint venture and a gain on the sale of certain manufacturing facilities and related assets recorded in 2011, and the charge for the *Vioxx* Liability Reserve and the income recognized on AstraZeneca's asset option exercise both recognized in 2010. In addition, the amortization of purchase accounting adjustments and other acquisition-related costs, intangible asset impairment charges, restructuring costs, taxes paid at the joint venture level and a portion of equity income are also excluded from the determination of segment profits. Additionally, segment profits do not reflect other expenses from corporate and manufacturing cost centers and other miscellaneous income or expense. These unallocated items are reflected in "Other" in the above table. Also included in "Other" are miscellaneous corporate profits (losses), as well as operating profits (losses) related to third-party manufacturing sales, divested products or businesses, and other supply sales.

Pharmaceutical segment profits increased 1% in 2012 driven primarily by lower operating expenses mostly offset by the effects of the loss of U.S. market exclusivity for *Singulair*. Pharmaceutical segment profits rose 7% in 2011 driven largely by the increase in sales and the gross margin improvement discussed above.

Taxes on Income

The effective income tax rates of 27.9% in 2012, 12.8% in 2011 and 40.6% in 2010 reflect the impacts of acquisition-related costs and restructuring costs, partially offset by the beneficial impact of foreign earnings. The effective tax rate for 2012 also reflects the favorable impacts of a tax settlement with the Canada Revenue Agency (the "CRA"), the realization of foreign tax credits and the impact of a favorable ruling on a state tax matter. In addition, the 2012 effective tax rate reflects the unfavorable impact of the net charge recorded in connection with the settlement of the ENHANCE Litigation for which no tax benefit was recorded and does not reflect any impacts for the R&D tax credit, which expired on December 31, 2011. As a result of legislation passed in 2013 that extended the R&D tax credit, both the 2012 and 2013 R&D tax credits will be recognized in 2013; however, the entire 2012 R&D tax credit will be recognized in the first quarter of 2013. The effective tax rate for 2011 reflects a net favorable impact of approximately $700 million relating to the settlement of Merck's 2002-2005 federal income tax audit, the favorable impact of certain foreign and state tax rate changes that resulted in a net $270 million reduction of deferred tax liabilities on intangibles established in purchase accounting, and the unfavorable impact of the $500 million charge related to the resolution of the arbitration proceeding with J&J. The 2010 effective tax rate reflects the impact of the *Vioxx* Liability Reserve for which no tax impact was recorded, a $147 million charge associated with a change in tax law that requires taxation of the prescription drug subsidy of the Company's retiree health benefit plans which was enacted in the first quarter of 2010 as part of U.S. health care reform legislation, and the impact of AstraZeneca's asset option exercise. These unfavorable impacts were partially offset by a $391 million tax benefit from changes in a foreign entity's tax rate, which resulted in a reduction in deferred tax liabilities on product intangibles recorded in conjunction with the Merger, and the favorable impact of foreign earnings and dividends from the Company's foreign subsidiaries.

Net Income and Earnings per Common Share

Net income attributable to Merck & Co., Inc. was $6.2 billion in 2012, $6.3 billion in 2011 and $861 million in 2010. EPS was $2.00 in 2012, $2.02 in 2011 and $0.28 in 2010. The decreases in net income and EPS in 2012 as compared with 2011 were due primarily to the net charge recorded in connection with the settlement of the ENHANCE Litigation, the effects of the loss of U.S. market exclusivity for *Singulair* in 2012 and the favorable impact of tax items in 2011, partially offset by lower marketing and administrative expenses, lower restructuring costs and lower intangible asset impairment charges in 2012 and the arbitration settlement charge recorded in 2011. The increases in net income and EPS in 2011 as compared with 2010 were primarily due to lower IPR&D impairment charges and amortization of inventory step-up, lower legal reserves and the favorable impact of tax settlements, partially offset by the arbitration settlement charge recorded in 2011 and the income recognized in 2010 on AstraZeneca's asset option exercise.

Non-GAAP Income and Non-GAAP EPS

Non-GAAP income and non-GAAP EPS are alternative views of the Company's performance used by management that Merck is providing because management believes this information enhances investors' understanding of the Company's results. Non-GAAP income and non-GAAP EPS exclude certain items because of the nature of these items and the impact that they have on the analysis of underlying business performance and trends. The excluded items consist of acquisition-related costs, restructuring costs and certain other items. These excluded items are significant components in understanding and assessing financial performance. Therefore, the information on non-GAAP income and non-GAAP EPS should be considered in addition to, but not in lieu of, net income and EPS prepared in accordance with generally accepted accounting principles in the United States ("GAAP"). Additionally, since non-GAAP income and non-GAAP EPS are not measures determined in accordance with GAAP, they have no standardized meaning prescribed by GAAP and, therefore, may not be comparable to the calculation of similar measures of other companies.

Non-GAAP income and non-GAAP EPS are important internal measures for the Company. Senior management receives a monthly analysis of operating results that includes non-GAAP income and non-GAAP EPS and the performance of the Company is measured on this basis along with other performance metrics. Senior management's annual compensation is derived in part using non-GAAP income and non-GAAP EPS.

A reconciliation between GAAP financial measures and non-GAAP financial measures is as follows:

($ in millions except per share amounts)	**2012**	2011	2010
Pretax income as reported under GAAP	**$ 8,739**	$ 7,334	$ 1,653
Increase (decrease) for excluded items:			
Acquisition-related costs	**5,344**	5,939	9,403
Restructuring costs	**999**	1,911	1,986
Other items:			
Net charge related to settlement of ENHANCE Litigation	**493**	—	—
Arbitration settlement charge	**—**	500	—
Gain on disposition of interest in JJMCP joint venture	**—**	(136)	—
Gain on sale of manufacturing facilities and related assets	**—**	(127)	—
Vioxx Liability Reserve	**—**	—	950
Income recognized on AstraZeneca's asset option exercise	**—**	—	(443)
Other	**—**	5	—
	15,575	15,426	13,549
Taxes on income as reported under GAAP	**2,440**	942	671
Estimated tax benefit (expense) on excluded items	**1,261**	1,697	1,798
Tax benefit from settlement of federal income tax audit	**—**	700	—
Tax benefit from foreign and state tax rate changes	**—**	270	391
Tax charge related to U.S. health care reform legislation	**—**	—	(147)
	3,701	3,609	2,713
Non-GAAP net income	**11,874**	11,817	10,836
Less: Net income attributable to noncontrolling interests	**131**	120	121
Non-GAAP net income attributable to Merck & Co., Inc.	**$11,743**	$11,697	$10,715
EPS assuming dilution as reported under GAAP	**$ 2.00**	$ 2.02	$ 0.28
EPS difference[(1)]	**1.82**	1.75	3.14
Non-GAAP EPS assuming dilution	**$ 3.82**	$ 3.77	$ 3.42

[(1)] *Represents the difference between calculated GAAP EPS and calculated non-GAAP EPS, which may be different than the amount calculated by dividing the impact of the excluded items by the weighted-average shares for the applicable year.*

Acquisition-Related Costs

Non-GAAP income and non-GAAP EPS exclude the impact of certain amounts recorded in connection with mergers and acquisitions. These amounts include the amortization of intangible assets and inventory step-up, as well as intangible asset impairment charges. Also excluded are incremental, third-party integration costs associated with the Merger, such as costs related to legal entity and system integration, as well as other costs associated with mergers and acquisitions, such as severance costs which are not part of the Company's formal restructuring programs. These costs are excluded because management believes that these costs are not representative of ongoing normal business activities.

Restructuring Costs

Non-GAAP income and non-GAAP EPS exclude costs related to restructuring actions, including restructuring activities related to the Merger (see Note 3 to the consolidated financial statements). These amounts include employee separation costs and accelerated depreciation associated with facilities to be closed or divested. Accelerated depreciation costs represent the difference between the depreciation expense to be recognized over the revised useful life of the site, based upon the anticipated date the site will be closed or divested, and depreciation expense as determined utilizing the useful life prior to the restructuring actions. The Company has undertaken restructurings of different types during the covered periods and therefore these charges should not be considered non-recurring; however, management excludes these amounts from non-GAAP income and non-GAAP EPS because it believes it is helpful for understanding the performance of the continuing business.

Certain Other Items

Non-GAAP income and non-GAAP EPS exclude certain other items. These items represent substantive, unusual items that are evaluated on an individual basis. Such evaluation considers both the quantitative and the qualitative aspect of their unusual nature and generally represent items that, either as a result of their nature or magnitude, management would not anticipate that they would occur as part of the Company's normal business on a regular basis. Certain other items are comprised of the net charge recorded in connection with the settlement of the ENHANCE Litigation, the arbitration settlement charge, the gain on the disposition of the Company's interest in the JJMCP joint venture, the gain associated with the sale of certain manufacturing facilities and related assets, the charge to establish the *Vioxx* Liability Reserve and the income recognized upon AstraZeneca's asset option exercise. Also excluded from non-GAAP income and non-GAAP EPS are the tax benefits from the settlement of a federal income tax audit, the favorable impact of certain foreign and state tax rate changes that resulted in a net reduction of deferred tax liabilities on intangibles established in purchase accounting, and the tax charge related to U.S. health care reform legislation.

Research and Development

A chart reflecting the Company's current research pipeline as of February 22, 2013 is set forth in Item 1. "Business — Research and Development" above.

Research and Development Update

The Company currently has four candidates under regulatory review in the United States and internationally.

MK-4305, suvorexant, an investigational insomnia medicine in a new class of medicines called orexin receptor antagonists for use in patients with difficulty falling or staying asleep, is under review by the FDA. Suvorexant will be evaluated by the Controlled Substance Staff of the FDA during NDA review. If approved by the FDA, suvorexant will become available after a schedule assessment and determination has been completed by the U.S. Drug Enforcement Administration, which routinely occurs after FDA approval. The Company has also submitted a new drug application for suvorexant to the health authorities in Japan and is continuing with plans to seek approval for suvorexant in other countries around the world.

MK-8616, sugammadex sodium injection, is an investigational agent for the reversal of neuromuscular blockade induced by rocuronium or vecuronium (neuromuscular blocking agents) under review by the FDA. Neuromuscular blockade is used in anesthesiology to induce muscle relaxation during surgery. If approved, MK-8616 would be the first in a new class of medicines in the United States known as selective relaxant binding agents to be used in the surgical setting. In 2008, the FDA did not approve the original NDA for sugammadex sodium injection, requesting additional data related to hypersensitivity (allergic) reactions and coagulation (bleeding) events. Merck submitted these requested data within the NDA resubmission, which the FDA deemed complete for review. The Company expects the FDA's review to be completed in the first half of 2013. Sugammadex sodium injection is approved and has been launched in many countries outside of the United States where it is marketed as *Bridion*.

MK-8109, vintafolide, is an investigational cancer candidate under review by the EMA. As part of an exclusive license agreement with Endocyte, Merck is responsible for the development and worldwide commercialization of vintafolide in oncology. The EMA accepted the marketing authorization application filings for vintafolide and Endocyte's investigational companion diagnostic imaging agent, etarfolatide, for the targeted treatment of patients with folate-receptor positive platinum-resistant ovarian cancer in combination with pegylated liposomal doxorubicin. Both vintafolide and etarfolatide have been granted orphan drug status by the EC. Vintafolide is in Phase III development in the United States.

MK-0653C is an investigational combination of ezetimibe and atorvastatin for the treatment of primary or mixed hyperlipidemia under review by the FDA. An updated NDA for MK-0653C was deemed complete for review by the FDA after Merck submitted additional data in response to the FDA's Complete Response Letter issued in 2012. Merck expects the FDA's review to be completed in the first half of 2013. Merck is continuing to move forward with planned filings for the ezetimibe and atorvastatin combination tablet in additional countries around the world.

In addition to the candidates under regulatory review, the Company has 16 drug candidates in Phase III development targeting a broad range of diseases. The Company anticipates filing an NDA or a BLA, as applicable, with the FDA with respect to several of these candidates in 2013.

V503 is a nine-valent HPV vaccine in development to help protect against certain HPV-related diseases. V503 incorporates antigens against five additional cancer-causing HPV types as compared with *Gardasil*. As previously disclosed, the 14,000-patient Phase III event-driven clinical study of V503 is ongoing. Merck anticipates filing a BLA for V503 with the FDA in 2013.

MK-8962, corifollitropin alpha injection, which is being marketed as *Elonva* in the EU, is an investigational fertility treatment for controlled ovarian stimulation in women participating in *in vitro* fertilization or intracytoplasmic sperm injection currently in Phase III development in the United States. Merck continues to anticipate filing an NDA for MK-8962 with the FDA in 2013.

MK-5348, vorapaxar, is a thrombin receptor antagonist being developed for the prevention of thrombosis, or clot formation, and the reduction of cardiovascular events. Vorapaxar has been evaluated in two major clinical outcomes studies in different patient groups: TRACER (Thrombin Receptor Antagonist for Clinical Event Reduction in Acute Coronary Syndrome), a clinical outcomes trial in patients with acute coronary syndrome, and TRA-2P (Thrombin Receptor Antagonist in Secondary Prevention of atherothrombotic ischemic events), a secondary prevention study in patients with a previous heart attack or ischemic stroke, or with documented peripheral vascular disease. In March 2012, results from the TRA-2P study of vorapaxar were presented at the American College of Cardiology Annual Scientific Session and published concurrently in the online edition of the New England Journal of Medicine. In the study, the addition of vorapaxar to standard of care (e.g. aspirin or thienopyridine or both) resulted in a significantly greater reduction in the risk of the composite of cardiovascular death, heart attack, stroke or urgent coronary revascularization. There was also a significant increase in bleeding, including intracranial hemorrhage, among patients taking vorapaxar in addition to standard of care, although the risk of intracranial hemorrhage was lower in patients without a history of stroke. In November 2011, researchers presented results from the TRACER outcomes study at the American Heart Association Scientific Sessions, and the results have been published. TRACER did not achieve its primary endpoint. In January 2011, Merck and the external study investigators announced that the combined DSMB for the two clinical trials had reviewed the available safety and efficacy data, and recommended that patients in the TRACER trial discontinue study drug and investigators close out the study. Following a review of the clinical trial data and discussions with external experts, Merck plans to file applications for vorapaxar in the United States and EU in 2013 seeking an indication for the prevention of cardiovascular events in patients with a history of heart attack and no history of transient ischemic attack or stroke.

MK-7243 is an investigational allergy immunotherapy sublingual tablet ("AIT") in Phase III development for grass pollen allergy for which the Company has North American rights. AIT is a dissolvable oral tablet that is designed to prevent allergy symptoms by inducing a protective immune response against allergies, thereby treating the underlying cause of the disease. Merck is investigating AIT for the treatment of grass pollen allergic rhinoconjunctivitis in both children and adults. The Company has submitted a BLA for MK-7243 with the FDA.

MK-3641, an AIT for ragweed allergy, is also in Phase III development for the North American market. The Company anticipates filing a BLA for MK-3641 with the FDA in 2013.

MK-8175A, NOMAC/E2, which is being marketed as *Zoely* in the EU, is an investigational oral contraceptive for use by women to prevent pregnancy. NOMAC/E2 is a combined oral contraceptive tablet containing a unique monophasic combination of two hormones: nomegestrol acetate, a highly selective progesterone-derived progestin, and 17-beta estradiol, an estrogen that is similar to the one naturally present in a women's body. In November 2011, Merck received a Complete Response Letter from the FDA for NOMAC/E2. The Company is conducting an additional clinical study requested by the FDA and plans to update the application in the future.

MK-0822, odanacatib, is an oral, once-weekly investigational treatment for osteoporosis in post-menopausal women. Osteoporosis is a disease that reduces bone density and strength and results in an increased risk of bone fractures. Odanacatib is a cathepsin K inhibitor that selectively inhibits the cathepsin K enzyme. Cathepsin K is known to play a central role in the function of osteoclasts, which are cells that break down existing bone tissue, particularly the protein components of bone. Inhibition of cathepsin K is a novel approach to the treatment of osteoporosis. In July 2012, Merck announced an update on the Phase III trial assessing fracture risk reduction with odanacatib. The independent Data Monitoring Committee (the "DMC") for the study completed its first planned interim analysis for efficacy and recommended that the study be closed early due to robust efficacy and a favorable benefit-risk profile. The DMC noted that safety issues remain in certain selected areas and made recommendations with respect to following up on them. On February 1, 2013, Merck announced that it had recently received and was reviewing safety and efficacy data from the Phase III trial. As a result of its review of this data, the Company concluded that review of additional data from the previously planned, ongoing extension study was warranted and that filing an application for approval with the FDA should be delayed. As previously announced, the Company is conducting a blinded extension of the trial in approximately 8,200 women, which will provide additional safety and efficacy data. Merck now anticipates that it will file applications for approval of odanacatib in 2014 with additional data from the extension trial. The Company continues to believe that odanacatib will have the potential to address unmet medical needs in patients with osteoporosis.

MK-3814, preladenant, is a selective adenosine 2a receptor antagonist in Phase III development for treatment of Parkinson's disease. The Company anticipates filing an NDA for MK-3814 with the FDA in 2014.

V212 is an inactivated VZV vaccine in development for the prevention of herpes zoster. The Company is enrolling two Phase III trials, one in autologous hematopoietic cell transplant patients and the other in patients with solid tumor malignancies undergoing chemotherapy and hematological malignancies. The Company anticipates filing a BLA first with the autologous hematopoietic cell transplant data in 2014 and filing for the second indication in cancer patients at a later date.

V419 is an investigational hexavalent pediatric combination vaccine, which contains components of current vaccines, designed to help protect against six potentially serious diseases: diphtheria, tetanus, whooping cough (*Bordetella pertussis*), polio (poliovirus types 1, 2, and 3), invasive disease caused by *Haemophilus influenzae* type b, and hepatitis B that is being developed in collaboration with Sanofi-Pasteur. The Company anticipates filing a BLA for V419 with the FDA in 2014.

MK-7009, vaniprevir, is an investigational, oral twice-daily protease inhibitor for the treatment of chronic hepatitis C virus for development in Japan only. The Company anticipates filing a new drug application for MK-7009 in Japan in 2014.

MK-3102 is an investigational once-weekly DPP-4 inhibitor in development for the treatment of type 2 diabetes. The Company anticipates filing an NDA for MK-3102 with the FDA beyond 2014.

MK-3222 is an anti-interleukin-23 monoclonal antibody candidate being investigated for the treatment of psoriasis. The Company anticipates filing a BLA for MK-3222 with the FDA beyond 2014.

MK-3415A, actoxumab/bezlotoxumab, an investigational candidate for the treatment of *Clostridium difficile* infection, is a combination of two monoclonal antibodies used to treat patients with a single infusion. The Company now anticipates filing a BLA for MK-3415A with the FDA in 2015.

MK-0859, anacetrapib, is an investigational inhibitor of the cholesteryl ester transfer protein ("CETP") that is being investigated in lipid management to raise HDL-C and reduce LDL-C. Based on the results from the Phase III DEFINE (Determining the EFficacy and Tolerability of CETP INhibition with AnacEtrapib) safety study of 1,623 patients with coronary heart disease or coronary heart disease risk equivalents, the Company initiated a large, event-driven cardiovascular clinical outcomes trial REVEAL (Randomized EValuation of the Effects of Anacetrapib Through Lipid-modification) involving patients with preexisting vascular disease that is predicted to be completed in 2017. The Company continues to anticipate filing an NDA for anacetrapib with the FDA beyond 2015.

MK-8931 is Merck's novel investigational oral ß-amyloid precursor protein site-cleaving enzyme (BACE) inhibitor for the treatment of Alzheimer's disease. In December 2012, Merck announced the initiation of a Phase II/III clinical trial (EPOCH) designed to evaluate the safety and efficacy of MK-8931 versus placebo in patients with mild-to-moderate Alzheimer's disease.

MK-8669, ridaforolimus, is an investigational oral mTOR (mammalian target of rapamycin) inhibitor under development for cancer indications. In June 2012, Merck announced that the FDA issued a Complete Response Letter regarding the NDA for ridaforolimus as a treatment for metastatic soft tissue or bone sarcoma. The Complete Response Letter states that the FDA cannot approve the application in its present form, and that additional clinical trial(s) would need to be conducted to further assess safety and efficacy. In November 2012, Merck formally notified the EMA of its decision to withdraw the marketing authorization application for ridaforolimus that was accepted by the EMA in 2011. The Company no longer plans to pursue the sarcoma indication in the United States or the EU, but will continue to support patients enrolled in ongoing clinical trials. Merck remains committed to pursuing ridaforolimus in other cancer indications. As part of an exclusive license agreement with ARIAD Pharmaceuticals, Inc. ("ARIAD"), Merck is responsible for the development and worldwide commercialization of ridaforolimus in oncology.

In December 2012, Merck announced the HPS2-THRIVE study of MK-0524A, *Tredaptive*, did not meet its primary endpoint. In the study, adding the combination of extended-release niacin and laropiprant to statin therapy did not significantly further reduce the risk of the combination of coronary deaths, non-fatal heart attacks, strokes or revascularizations compared to statin therapy. In addition, there was a statistically significant increase in the incidence of some types of non-fatal serious adverse events in the group that received extended-release niacin/laropiprant compared to statin therapy. Merck does not plan to seek regulatory approval for the medicine in the United States. In January 2013, based on the understanding of the preliminary data from the HPS2-THRIVE study and in consultation with regulatory authorities, Merck began taking steps to suspend the availability of *Tredaptive*, which is approved for use in certain countries outside of the United States. The clinical development program for MK-0524B, a combination product of extended-release niacin with laropiprant and simvastatin, had previously been discontinued.

In 2012, Merck announced that it will return the global marketing and development rights for both the intravenous and oral formulations for vernakalant, a treatment for atrial fibrillation, to Cardiome Pharma Corp. for business reasons. Merck also decided in 2012 to discontinue the clinical development program for MK-0431E, a combination product of sitagliptin and atorvastatin for the treatment of type 2 diabetes, for business reasons.

The Company maintains a number of long-term exploratory and fundamental research programs in biology and chemistry as well as research programs directed toward product development. The Company's research and development model is designed to increase productivity and improve the probability of success by prioritizing the Company's research and development resources on disease areas of unmet medical needs, scientific opportunity and commercial opportunity. Merck is managing its research and development portfolio across diverse approaches to discovery and development by balancing investments appropriately on novel, innovative targets with the potential to have a major impact on human health, on developing best-in-class approaches, and on delivering maximum value of its approved medicines and vaccines through new indications and new formulations. Another important component of the Company's science-based diversification is based on expanding the Company's portfolio of modalities to include not only small molecules and vaccines, but also biologics (peptides, small proteins, antibodies) and RNAi. Further, Merck has moved to diversify its portfolio through biosimilars, which have the potential to harness the market opportunity presented by biological medicine patent expiries by delivering high quality follow-on biologic products to enhance access for patients worldwide. The Company supplements its internal research with a licensing and external alliance strategy focused on the entire spectrum of collaborations from early research to late-stage compounds, as well as new technologies.

The Company's clinical pipeline includes candidates in multiple disease areas, including atherosclerosis, cancer, cardiovascular diseases, diabetes, infectious diseases, inflammatory/autoimmune diseases, insomnia, neurodegenerative diseases, osteoporosis, respiratory diseases and women's health.

In-Process Research and Development

In connection with mergers and acquisitions, the Company has recorded the fair value of incomplete research projects which, at the time of acquisition, had not yet reached technological feasibility. At December 31, 2012, the balance of IPR&D was $2.4 billion.

Some of the more significant projects in late-stage development include sugammadex sodium injection and an ezetimibe/atorvastatin combination product, both of which are currently under review by the FDA as noted above, as well as vorapaxar, which remains in Phase III clinical development.

During 2012, 2011 and 2010, approximately $78 million, $666 million and $378 million, respectively, of IPR&D projects received marketing approval in a major market and the Company began amortizing these assets based on their estimated useful lives.

All of the IPR&D projects that remain in development are subject to the inherent risks and uncertainties in drug development and it is possible that the Company will not be able to successfully develop and complete the IPR&D programs and profitably commercialize the underlying product candidates. The time periods to receive approvals from the FDA and other regulatory agencies are subject to uncertainty. Significant delays in the approval process, or the Company's failure to obtain approval at all, would delay or prevent the Company from realizing revenues from these products. Additionally, if certain of the IPR&D programs fail or are abandoned during development, then the Company will not realize the future cash flows it has estimated and recorded as IPR&D as of the acquisition date, and the Company may also not recover the research and development expenditures made since the acquisition to further develop such program. If such circumstances were to occur, the Company's future operating results could be adversely affected and the Company may recognize impairment charges and such charges could be material.

During 2012, the Company recorded $200 million of IPR&D impairment charges within *Research and development* expenses primarily for pipeline programs that had previously been deprioritized and were subsequently deemed to have no alternative use during the period. During 2011, the Company recorded $587 million of IPR&D impairment charges primarily for pipeline programs that were abandoned and determined to have no alternative use, as well as for expected delays in the launch timing or changes in the cash flow assumptions for certain compounds. In addition, the impairment charges related to pipeline programs that had previously been deprioritized and were either deemed to have no alternative use during the period or were out-licensed to a third party for consideration that was less than the related asset's carrying value.

During 2010, the Company recorded $2.4 billion of IPR&D impairment charges. The Company determined that the developments in the clinical research program for vorapaxar constituted a triggering event that required the Company to evaluate the vorapaxar intangible asset for impairment. Utilizing market participant assumptions, and considering several different scenarios, the Company concluded that its best estimate of the current fair value of the intangible asset related to vorapaxar was $350 million, which resulted in the recognition of an impairment charge of $1.7 billion during 2010. The remaining $763 million of IPR&D impairment charges recorded in 2010 were attributable to compounds that were abandoned and determined to have either no alternative use or were returned to the respective licensor, as well as from expected delays in the launch timing or changes in the cash flow assumptions for certain compounds.

Additional research and development will be required before any of the remaining programs reach technological feasibility. The costs to complete the research projects will depend on whether the projects are brought to their final stages of development and are ultimately submitted to the FDA or other regulatory agencies for approval. As of December 31, 2012, the estimated costs to complete projects acquired in connection with mergers and acquisitions in Phase III development for human health and the analogous stage of development for animal health were approximately $1.2 billion.

Acquisitions, Research Collaborations and License Agreements

Merck continues to remain focused on pursuing opportunities that have the potential to drive both near- and long-term growth. During 2012, the Company completed transactions across a broad range of therapeutic categories, including early-stage technology transactions. Merck is actively monitoring the landscape for growth opportunities that meet the Company's strategic criteria.

In October 2012, Merck and AiCuris entered into an exclusive licensing agreement which provides Merck with worldwide rights to develop and commercialize candidates in AiCuris' novel portfolio of investigational medicines targeting human cytomegalovirus ("HCMV"), including letermovir (MK-8228), an oral, late-stage antiviral candidate being investigated for the treatment and prevention of HCMV infection in transplant recipients. AiCuris received an upfront payment of €110 million (approximately $140 million), which the Company recorded as research and development expense, and is eligible for milestone payments of up to €332.5 million based on successful achievement of development, regulatory and commercialization goals for HCMV candidates, including letermovir, an additional back-up candidate as well as other Phase I candidates designed to act via an alternate mechanism. In addition, AiCuris will be entitled to receive royalty payments reflecting the advanced stage of the clinical program on any potential products that result from the agreement. Merck will be responsible for all development activities and costs. The agreement may be terminated by either party in the event of a material uncured breach or insolvency. The agreement may be terminated by Merck at any time in the event that any of the compounds licensed from AiCuris develop an adverse safety profile or any material adverse issue arises related to the development, efficacy or dosing regimen of any of the compounds, and/or in the event that certain patents are invalid and/or unenforceable in certain jurisdictions. Merck (i) may terminate the agreement with respect to certain compounds after successful completion of the first proof of concept clinical trial or (ii) must terminate the agreement with respect to certain compounds if Merck fails to minimally invest in such compounds. In addition, Merck may terminate the agreement as a whole at any time upon six months prior written notice at any time after completion of the first Phase III clinical trial for a compound. AiCuris may terminate the agreement in the event that Merck challenges any AiCuris patent covering the compounds licensed from AiCuris. Upon termination of the agreement, depending upon the circumstances, the parties have varying rights and obligations with respect to the continued development and commercialization of compounds and, in the case of termination for cause by Merck, certain royalty obligations.

In April 2012, the Company entered into an agreement with Endocyte to develop and commercialize Endocyte's novel investigational therapeutic candidate vintafolide (MK-8109). Vintafolide is currently being evaluated in a Phase III clinical trial for folate-receptor positive platinum-resistant ovarian cancer (PROCEED) and a Phase II trial for non-small cell lung cancer. Under the agreement, Merck gained worldwide rights to develop and commercialize vintafolide. Endocyte received a $120 million upfront payment, which the Company recorded as research and development expense, and is eligible for milestone payments of up to $880 million based on the successful achievement of development, regulatory and commercialization goals for vintafolide for a total of six cancer indications. In addition, if vintafolide receives regulatory approval, Merck and Endocyte will share equally profit and losses in the United States. Endocyte will receive a royalty on sales of the product in the rest of the world. Endocyte has retained the right to co-promote vintafolide with Merck in the United States and Merck has the exclusive right to promote vintafolide in the rest of world. Endocyte will be responsible for the majority of funding and completion of the PROCEED trial. Merck will be responsible for all other development activities and development costs and have all decision rights for vintafolide. Merck has the right to terminate the agreement on 90 days notice. Merck and Endocyte both have the right to terminate the agreement due to the material breach or insolvency of the other party. Endocyte has the right to terminate the agreement in the event that Merck challenges an Endocyte patent right relating to vintafolide. Upon termination of the agreement, depending upon the circumstances, the parties have varying rights and obligations with respect to the continued development and commercialization of vintafolide and, in the case of termination for cause by Merck, certain royalty obligations and U.S. profit and loss sharing. Endocyte is responsible for the development, manufacture and commercialization worldwide of etarfolatide, a non-invasive companion diagnostic imaging agent that is used to identify folate receptor positive tumor cells. As discussed above, in 2012, the EMA accepted the marketing authorization application filings for vintafolide and etarfolatide for platinum resistant ovarian cancer.

Selected Joint Venture and Affiliate Information

To expand its research base and realize synergies from combining capabilities, opportunities and assets, in previous years Merck has formed a number of joint ventures.

AstraZeneca LP

In 1982, Merck entered into an agreement with Astra AB ("Astra") to develop and market Astra products under a royalty-bearing license. In 1993, Merck's total sales of Astra products reached a level that triggered the first step in the establishment of a joint venture business carried on by Astra Merck Inc. ("AMI"), in which Merck and Astra each owned a 50% share. This joint venture, formed in 1994, developed and marketed most of Astra's new prescription medicines in the United States including Prilosec, the first of a class of medications known as proton pump inhibitors, which slows the production of acid from the cells of the stomach lining.

In 1998, Merck and Astra completed the restructuring of the ownership and operations of the joint venture whereby Merck acquired Astra's interest in AMI, renamed KBI Inc. ("KBI"), and contributed KBI's operating assets to a new U.S. limited partnership, Astra Pharmaceuticals L.P. (the "Partnership"), in exchange for a

1% limited partner interest. Astra contributed the net assets of its wholly owned subsidiary, Astra USA, Inc., to the Partnership in exchange for a 99% general partner interest. The Partnership, renamed AstraZeneca LP ("AZLP") upon Astra's 1999 merger with Zeneca Group Plc, became the exclusive distributor of the products for which KBI retained rights.

While maintaining a 1% limited partner interest in AZLP, Merck has consent and protective rights intended to preserve its business and economic interests, including restrictions on the power of the general partner to make certain distributions or dispositions. Furthermore, in limited events of default, additional rights will be granted to the Company, including powers to direct the actions of, or remove and replace, the Partnership's chief executive officer and chief financial officer. Merck earns ongoing revenue based on sales of KBI products and such revenue was $915 million, $1.2 billion and $1.3 billion in 2012, 2011 and 2010, respectively, primarily relating to sales of Nexium, as well as Prilosec. In addition, Merck earns certain Partnership returns which are recorded in *Equity income from affiliates.* Such returns include a priority return provided for in the Partnership Agreement, a preferential return representing Merck's share of undistributed AZLP GAAP earnings, and a variable return related to the Company's 1% limited partner interest. These returns aggregated $621 million, $574 million and $546 million in 2012, 2011 and 2010, respectively.

In conjunction with the 1998 restructuring discussed above, Astra purchased an option (the "Asset Option") for a payment of $443 million, which was recorded as deferred income, to buy Merck's interest in the KBI products, excluding the gastrointestinal medicines Nexium and Prilosec (the "Non-PPI Products"). In April 2010, AstraZeneca exercised the Asset Option. Merck received $647 million from AstraZeneca representing the net present value as of March 31, 2008 of projected future pretax revenue to be received by Merck from the Non-PPI Products, which was recorded as a reduction to the Company's investment in AZLP. The Company recognized the $443 million of deferred income in 2010 as a component of *Other (income) expense, net*. In addition, in 1998, Merck granted Astra an option to buy Merck's common stock interest in KBI and, through it, Merck's interest in Nexium and Prilosec as well as AZLP, exercisable in 2012. In June 2012, Merck and AstraZeneca amended the 1998 option agreement. The updated agreement eliminated AstraZeneca's option to acquire Merck's interest in KBI in 2012 and provides AstraZeneca a new option to acquire Merck's interest in KBI in June 2014. As a result of the amended agreement, Merck continues to record supply sales and equity income from the partnership. In 2014, AstraZeneca has the option to purchase Merck's interest in KBI based in part on the value of Merck's interest in Nexium and Prilosec. AstraZeneca's option is exercisable between March 1, 2014 and April 30, 2014. If AstraZeneca chooses to exercise this option, the closing date is expected to be June 30, 2014. Under the amended agreement, AstraZeneca will make a payment to Merck upon closing of $327 million, reflecting an estimate of the fair value of Merck's interest in Nexium and Prilosec. This portion of the exercise price is subject to a true-up in 2018 based on actual sales from closing in 2014 to June 2018. The exercise price will also include an additional amount equal to a multiple of ten times Merck's average 1% annual profit allocation in the partnership for the three years prior to exercise. The Company believes that it is likely that AstraZeneca will exercise its option in 2014. If AstraZeneca exercises its option, the Company will no longer record equity income from AZLP and supply sales to AZLP will decline substantially.

Sanofi Pasteur MSD

In 1994, Merck and Pasteur Mérieux Connaught (now Sanofi Pasteur S.A.) established an equally-owned joint venture to market vaccines in Europe and to collaborate in the development of combination vaccines for distribution in Europe.

Sales of joint venture products were as follows:

($ in millions)	**2012**	2011	2010
Gardasil	**$ 264**	$ 253	$ 350
Influenza vaccines	**161**	183	220
Other viral vaccines	**107**	105	93
RotaTeq	**47**	44	42
Hepatitis vaccines	**31**	39	25
Other vaccines	**474**	486	487
	$1,084	$1,110	$1,217

Johnson & Johnson°Merck Consumer Pharmaceuticals Company

In September 2011, Merck sold its 50% interest in the JJMCP joint venture to J&J. The venture between Merck and J&J was formed in 1989 to develop, manufacture, market and distribute certain over-the-counter consumer products in the United States and Canada. Merck received a one-time payment of $175 million and recognized a pretax gain of $136 million in 2011 reflected in *Other (income) expense, net*. The partnership assets also included a manufacturing facility. Sales of products marketed by the joint venture were $62 million for the period from January 1, 2011 until the September 29, 2011 divestiture date and $129 million for 2010.

Capital Expenditures

Capital expenditures were $2.0 billion in 2012, $1.7 billion in 2011 and $1.7 billion in 2010. Expenditures in the United States were $1.3 billion in 2012, $1.2 billion in 2011 and $990 million in 2010.

Depreciation expense was $2.0 billion in 2012, $2.4 billion in 2011 and $2.6 billion in 2010 of which $1.3 billion, $1.4 billion and $1.7 billion, respectively, applied to locations in the United States. Total depreciation expense in 2012, 2011 and 2010 included accelerated depreciation of $235 million, $589 million and $849 million, respectively, associated with restructuring activities (see Note 3 to the consolidated financial statements).

Analysis of Liquidity and Capital Resources

Merck's strong financial profile enables it to fully fund research and development, focus on external alliances, support in-line products and maximize upcoming launches while providing significant cash returns to shareholders.

Selected Data

($ in millions)	**2012**	2011	2010
Working capital	**$16,509**	$16,936	$13,423
Total debt to total liabilities and equity	**19.4%**	16.7%	16.9%
Cash provided by operations to total debt	**0.5:1**	0.7:1	0.6:1

Cash provided by operating activities was $10.0 billion in 2012, $12.4 billion in 2011 and $10.8 billion in 2010. Cash provided by operating activities in 2012 reflects higher contributions of $1.3 billion to its defined benefit plans as compared with 2011. Cash provided by operating activities in 2012 also reflects the payment of $960 million (including interest) related to the resolution of certain litigation related to *Vioxx*. The increase in cash provided by operating activities in 2011 as compared with 2010 reflects increased results of operations, partially offset by a $500 million payment made to J&J as a result of the arbitration settlement, as well as net payments of approximately $465 million to the Internal Revenue Service (the "IRS") as a result of the conclusion of its examination of certain of Merck's federal income tax returns as discussed below. Cash provided by operating activities continues to be the Company's primary source of funds to finance operating needs, capital expenditures, treasury stock purchases and dividends paid to shareholders. The global economic downturn and the sovereign debt issues, among other factors, have adversely affected foreign receivables in certain European countries (see Note 6 to the consolidated financial statements). The Company continues to receive payment on these receivables, including significant collections during 2012 in connection with the Spanish government's debt stabilization/stimulus plan. Additionally, the Company continues to expand in the emerging markets where payment terms tend to be longer. The conditions in the EU and the emerging markets have resulted in an increase in the average length of time it takes to collect accounts receivable outstanding thereby adversely affecting cash provided by operating activities.

Cash used in investing activities was $6.8 billion in 2012 compared with $2.9 billion in 2011 primarily reflecting higher purchases of securities and other investments, partially offset by higher proceeds from the sales of securities and other investments. Cash used in investing activities was $2.9 billion in 2011 compared with $3.5 billion in 2010 primarily reflecting higher proceeds from the sales of securities and other investments and proceeds from the disposition of certain businesses, partially offset by higher purchases of securities and other investments. In addition, in 2010, proceeds from AstraZeneca's asset option exercise and a decrease in restricted assets contributed to cash flows from investing activities.

Cash used in financing activities in 2012 was $3.3 billion compared with $6.9 billion in 2011. The lower use of cash in financing activities was primarily driven by proceeds from the issuance of debt, lower payments on debt and higher proceeds from the exercise of stock options, partially offset by increased purchases of treasury stock, a decrease in short-term borrowings and higher dividends paid to stockholders. Cash used in financing activities was $6.9 billion in 2011 compared with $5.4 billion in 2010. The higher use of cash in financing activities was primarily driven by lower proceeds from the issuance of debt, higher purchases of treasury stock and higher payments on debt, partially offset by an increase in short-term borrowings.

In an effort to implement Merck's strategy to expand product offerings and capabilities in the emerging markets, the Company has and, anticipates in the future, will allocate capital and resources across those regions.

At December 31, 2012, the total of worldwide cash and investments was $23.4 billion, including $16.1 billion of cash, cash equivalents and short-term investments, and $7.3 billion of long-term investments. Generally 80%-90% of these cash and investments are held by foreign subsidiaries and would be subject to significant tax payments if such cash and investments were repatriated in the form of dividends. The Company records U.S. deferred tax liabilities for certain unremitted earnings, but when amounts earned overseas are expected to be indefinitely reinvested outside of the United States, no accrual for U.S. taxes is provided. The amount of cash and investments held by U.S. and foreign subsidiaries fluctuates due to a variety of factors including the timing and receipt of payments in the normal course of business. Cash provided by operating activities in the United States continues to be the Company's primary source of funds to finance domestic operating needs, capital expenditures, treasury stock purchases and dividends paid to shareholders.

As previously disclosed, the Canada Revenue Agency (the "CRA") had proposed adjustments for 1999 and 2000 relating to intercompany pricing matters and, in July 2011, the CRA issued assessments for other miscellaneous audit issues for tax years 2001-2004. In 2012, Merck and the CRA reached a settlement for these years that calls for Merck to pay additional Canadian tax of approximately $65 million. The Company's unrecognized tax benefits related to these matters exceeded the settlement amount and therefore the Company recorded a net $112 million tax provision benefit in 2012. A portion of the taxes paid is expected to be creditable for U.S. tax purposes. The Company had previously established reserves for these matters. The resolution of these matters did not have a material effect on the Company's results of operations, financial position or liquidity.

In April 2011, the IRS concluded its examination of Merck's 2002-2005 federal income tax returns and as a result the Company was required to make net payments of approximately $465 million. The Company's unrecognized tax benefits for the years under examination exceeded the adjustments related to this examination period and therefore the Company recorded a net $700 million tax provision benefit in 2011. This net benefit reflects the decrease of unrecognized tax benefits for the years under examination partially offset by increases to unrecognized tax benefits for years subsequent to the examination period as a result of this settlement. The Company disagrees with the IRS treatment of one issue raised during this examination and is appealing the matter through the IRS administrative process.

The Company's contractual obligations as of December 31, 2012 are as follows:

Payments Due by Period

($ in millions)	Total	2013	2014—2015	2016—2017	Thereafter
Purchase obligations[(1)]	$ 1,241	$ 551	$ 505	$ 176	$ 9
Loans payable and current portion of long-term debt	4,288	4,288	—	—	—
Long-term debt	15,803	—	4,129	1,936	9,738
Interest related to debt obligations	8,758	800	1,277	1,022	5,659
ENHANCE Litigation settlement[(2)]	688	688	—	—	—
Unrecognized tax benefits[(3)]	739	739	—	—	—
Operating leases	835	203	318	169	145
	$32,352	$7,269	$6,229	$3,303	$15,551

(1) *During 2011, Merck entered into a transaction which will require the Company to make future bulk supply purchases of $150 million over a maximum four-year period commencing upon the occurrence of certain predetermined events. This amount is not reflected in the table because the predetermined events have not yet occurred and therefore the timing of the resulting payments in any given year cannot yet be determined.*

(2) *As discussed in Note 11 to the consolidated financial statements, the Company settled the ENHANCE Litigation. Assuming the settlement is approved by the court, the Company anticipates it will pay $688 million in 2013 in connection with the settlement; however, the Company expects that $195 million of this amount will be recovered through insurance.*

(3) *As of December 31, 2012, the Company's Consolidated Balance Sheet reflects liabilities for unrecognized tax benefits, interest and penalties of $5.6 billion, including $739 million reflected as a current liability. Due to the high degree of uncertainty regarding the timing of future cash outflows of liabilities for unrecognized tax benefits beyond one year, a reasonable estimate of the period of cash settlement for years beyond 2013 cannot be made.*

Purchase obligations are enforceable and legally binding obligations for purchases of goods and services including minimum inventory contracts, research and development and advertising. Amounts reflected for research and development obligations do not include contingent milestone payments. Also excluded from research and development obligations are potential future funding commitments of up to approximately $130 million for investments in research venture capital funds. Loans payable and current portion of long-term debt reflects $328 million of long-dated notes that are subject to repayment at the option of the holders. Required funding obligations for 2013 relating to the Company's pension and other postretirement benefit plans are not expected to be material. However, the Company currently anticipates contributing approximately $340 million and $40 million, respectively, to its pension plans and other postretirement benefit plans during 2013.

In May 2012, the Company terminated its existing credit facilities and entered into a new $4.0 billion, five-year credit facility maturing in May 2017. The facility provides backup liquidity for the Company's commercial paper borrowing facility and is to be used for general corporate purposes. The Company has not drawn funding from this facility.

In September 2012, the Company closed an underwritten public offering of $2.5 billion senior unsecured notes consisting of $1.0 billion aggregate principal amount of 1.1% notes due 2018, $1.0 billion aggregate principal amount of 2.4% notes due 2022 and $500 million aggregate principal amount of 3.6% notes due 2042. Interest on the notes is payable semi-annually. The notes of each series are redeemable in whole or in part at any time at the Company's option at varying redemption prices. Proceeds from the notes were used for general corporate purposes, including contributions to the Company's pension plans and the repayment of outstanding commercial paper and certain debt maturities.

In December 2012, the Company filed a securities registration statement with the Securities and Exchange Commission ("SEC") under the automatic shelf registration process available to "well-known seasoned issuers" which is effective for three years.

Effective as of November 3, 2009, the Company executed a full and unconditional guarantee of the then existing debt of its subsidiary Merck Sharp & Dohme Corp. ("MSD") and MSD executed a full and unconditional guarantee of the then existing debt of the Company (excluding commercial paper), including for payments of principal and interest. These guarantees do not extend to debt issued subsequent to that date.

The Company's long-term credit ratings assigned by Moody's Investors Service and Standard & Poor's are Aa3 with a stable outlook and AA with a stable outlook, respectively. These ratings continue to allow access to the capital markets and flexibility in obtaining funds on competitive terms. The Company continues to maintain a conservative financial profile. The Company places its cash and investments in instruments that meet high credit quality standards, as specified in its investment policy guidelines. These guidelines also limit the amount of credit exposure to any one issuer. Despite this strong financial profile, certain contingent events, if realized, which are discussed in Note 11 to the consolidated financial statements, could have a material adverse impact on the Company's liquidity and capital resources. The Company does not participate in any off-balance sheet arrangements involving unconsolidated subsidiaries that provide financing or potentially expose the Company to unrecorded financial obligations.

In November 2012, the Board of Directors declared a quarterly dividend of $0.43 per share on the Company's common stock payable in January 2013.

In April 2011, Merck's Board of Directors approved additional purchases of up to $5.0 billion of Merck's common stock for its treasury. The Company purchased $2.6 billion of its common stock (62 million shares) for its treasury during 2012. The Company has approximately $1.9 billion remaining under this program. The treasury stock purchases have no time limit and will be made over time on the open market, in block transactions or in privately negotiated transactions. The Company purchased $1.9 billion and $1.6 billion of its common stock during 2011 and 2010, respectively.

Financial Instruments Market Risk Disclosures

The Company manages the impact of foreign exchange rate movements and interest rate movements on its earnings, cash flows and fair values of assets and liabilities through operational means and through the use of various financial instruments, including derivative instruments.

A significant portion of the Company's revenues and earnings in foreign affiliates is exposed to changes in foreign exchange rates. The objectives and accounting related to the Company's foreign currency risk management program, as well as its interest rate risk management activities are discussed below.

Foreign Currency Risk Management

The Company has established revenue hedging, balance sheet risk management, and net investment hedging programs to protect against volatility of future foreign currency cash flows and changes in fair value caused by volatility in foreign exchange rates.

The objective of the revenue hedging program is to reduce the potential for longer-term unfavorable changes in foreign exchange rates to decrease the U.S. dollar value of future cash flows derived from foreign currency denominated sales, primarily the euro and Japanese yen. To achieve this objective, the Company will hedge a portion of its forecasted foreign currency denominated third-party and intercompany distributor entity sales that are expected to occur over its planning cycle, typically no more than three years into the future. The Company will layer in hedges over time, increasing the portion of third-party and intercompany distributor entity sales hedged as it gets closer to the expected date of the forecasted foreign currency denominated sales. The portion of sales hedged is based on assessments of cost-benefit profiles that consider natural offsetting exposures, revenue and exchange rate volatilities and correlations, and the cost of hedging instruments. The hedged anticipated sales are a specified component of a portfolio of similarly denominated foreign currency-based sales transactions, each of which responds to the hedged currency risk in the same manner. The Company manages its anticipated transaction exposure principally with purchased local currency put options, which provide the Company with a right, but not an obligation, to sell foreign currencies in the future at a predetermined price. If the U.S. dollar strengthens relative to the currency of the hedged anticipated sales, total changes in the options' cash flows offset the decline in the expected future U.S. dollar equivalent cash flows of the hedged foreign currency sales. Conversely, if the U.S. dollar weakens, the options' value reduces to zero, but the Company benefits from the increase in the U.S. dollar equivalent value of the anticipated foreign currency cash flows.

In connection with the Company's revenue hedging program, a purchased collar option strategy may be utilized. With a purchased collar option strategy, the Company writes a local currency call option and purchases a local currency put option. As compared to a purchased put option strategy alone, a purchased collar strategy reduces the upfront costs associated with purchasing puts through the collection of premium by writing call options. If the U.S. dollar weakens relative to the currency of the hedged anticipated sales, the purchased put option value of the collar strategy reduces to zero and the Company benefits from the increase in the U.S. dollar equivalent value of its anticipated foreign currency cash flows, however this benefit would be capped at the strike level of the written call. If the U.S. dollar strengthens relative to the currency of the hedged anticipated sales, the written call option value of the collar strategy reduces to zero and the changes in the purchased put cash flows of the collar strategy would offset the decline in the expected future U.S. dollar equivalent cash flows of the hedged foreign currency sales.

The Company may also utilize forward contracts in its revenue hedging program. If the U.S. dollar strengthens relative to the currency of the hedged anticipated sales, the increase in the fair value of the forward contracts offsets the decrease in the expected future U.S. dollar cash flows of the hedged foreign currency sales. Conversely, if the U.S. dollar weakens, the decrease in the fair value of the forward contracts offsets the increase in the value of the anticipated foreign currency cash flows. While a weaker U.S. dollar would result in a net benefit, the market value of Merck's hedges would have declined by an estimated $453 million and $330 million, respectively, from a uniform 10% weakening of the U.S. dollar at December 31, 2012 and 2011. The market value was determined using a foreign exchange option pricing model and holding all factors except exchange rates constant. Because Merck principally uses purchased local currency put options, a uniform weakening of the U.S. dollar would yield the largest overall potential loss in the market value of these options. The sensitivity measurement assumes that a change in one foreign currency relative to the U.S. dollar would not affect other foreign currencies relative to the U.S. dollar. Although not predictive in nature, the Company believes that a 10% threshold reflects reasonably possible near-term changes in Merck's major foreign currency exposures relative to the U.S. dollar. The cash flows from these contracts are reported as operating activities in the Consolidated Statement of Cash Flows.

The primary objective of the balance sheet risk management program is to mitigate the exposure of foreign currency denominated net monetary assets of foreign subsidiaries where the U.S. dollar is the functional currency from the effects of volatility in foreign exchange. In these instances, Merck principally utilizes forward exchange contracts, which enable the Company to buy and sell foreign currencies in the future at fixed exchange rates and economically offset the consequences of changes in foreign exchange from the monetary assets. Merck routinely enters into contracts to offset the effects of exchange on exposures denominated in developed country currencies, primarily the euro and Japanese yen. For exposures in developing country currencies, the Company will enter into forward contracts to partially offset the effects of exchange on exposures when it is deemed economical to do so based on a cost-benefit analysis that considers the magnitude of the exposure, the volatility of the exchange rate and the cost of the hedging instrument. The Company will also minimize the effect of exchange on monetary assets and liabilities by managing operating activities and net asset positions at the local level.

A sensitivity analysis to changes in the value of the U.S. dollar on foreign currency denominated derivatives, investments and monetary assets and liabilities indicated that if the U.S. dollar uniformly weakened by 10% against all currency exposures of the Company at December 31, 2012, *Income before taxes* would have declined by approximately $20 million in 2012. Because the Company was in a net short position relative to its major foreign currencies after consideration of forward contracts, a uniform weakening of the U.S. dollar will yield the largest overall potential net loss in earnings due to exchange. At December 31, 2011, the Company was in a net long position relative to its major foreign currencies after consideration of forward contracts, therefore a uniform 10% strengthening of the U.S. dollar would have reduced *Income before taxes* by approximately $165 million. This measurement assumes that a change in one foreign currency relative to the U.S. dollar would not affect other foreign currencies relative to the U.S. dollar. Although not predictive in nature, the Company believes that a 10% threshold reflects reasonably possible near-term changes in Merck's major foreign currency exposures relative to the U.S. dollar. The cash flows from these contracts are reported as operating activities in the Consolidated Statement of Cash Flows.

In February 2013, the Venezuelan government devalued its currency (Bolívar Fuertes) from 4.30 VEF per U.S. dollar to 6.30 VEF per U.S. dollar. The Company anticipates that it will recognize losses due to exchange of approximately $150 million in the first quarter of 2013 resulting from the remeasurement of the local monetary assets and liabilities at the new rate. Since January 2010, Venezuela has been designated hyperinflationary and, as a result, local foreign operations are remeasured in U.S. dollars with the impact recorded in results of operations. In addition, effective January 11, 2010, the Venezuelan government devalued its currency to a two-tiered official exchange rate with an “essentials rate” and a “non-essentials rate.” In December 2010, the Venezuelan government announced it would eliminate the essentials rate effective January 1, 2011. As a result of this announcement, the Company remeasured its December 31, 2010 monetary assets and liabilities at the new official rate.

The Company also uses forward exchange contracts to hedge its net investment in foreign operations against movements in exchange rates. The forward contracts are designated as hedges of the net investment in a foreign operation. The Company hedges a portion of the net investment in certain of its foreign operations and measures ineffectiveness based upon changes in spot foreign exchange rates. The effective portion of the unrealized gains or losses on these contracts is recorded in foreign currency translation adjustment within *Other Comprehensive Income* (“*OCI*”), and remains in *Accumulated Other Comprehensive Income* (“*AOCI”)* until either the sale or complete or substantially complete liquidation of the subsidiary. The cash flows from these contracts are reported as investing activities in the Consolidated Statement of Cash Flows.

Foreign exchange risk is also managed through the use of foreign currency debt. The Company’s senior unsecured euro-denominated notes have been designated as, and are effective as, economic hedges of the net investment in a foreign operation. Accordingly, foreign currency transaction gains or losses due to spot rate fluctuations on the euro-denominated debt instruments are included in foreign currency translation adjustment within *OCI*.

Interest Rate Risk Management

The Company may use interest rate swap contracts on certain investing and borrowing transactions to manage its net exposure to interest rate changes and to reduce its overall cost of borrowing. The Company does not use leveraged swaps and, in general, does not leverage any of its investment activities that would put principal capital at risk.

During 2011, the Company terminated pay-floating, receive-fixed interest rate swap contracts designated as fair value hedges of fixed-rate notes in which the notional amounts match the amount of the hedged fixed-rate notes. These swaps effectively converted certain of its fixed-rate notes to floating-rate instruments. The interest rate swap contracts were designated hedges of the fair value changes in the notes attributable to changes in the benchmark London Interbank Offered Rate (“LIBOR”) swap rate. As a result of the swap terminations, the Company received $288 million in cash, which included $43 million in accrued interest. The corresponding $245 million basis adjustment of the debt associated with the terminated interest rate swap contracts was deferred and is being amortized as a reduction of interest expense over the respective term of the notes. The cash flows from these contracts are reported as operating activities in the Consolidated Statement of Cash Flows.

The Company’s investment portfolio includes cash equivalents and short-term investments, the market values of which are not significantly affected by changes in interest rates. The market value of the Company’s medium- to long-term fixed-rate investments is modestly affected by changes in U.S. interest rates. Changes in medium- to long-term U.S. interest rates have a more significant impact on the market value of the Company’s fixed-rate borrowings, which generally have longer maturities. A sensitivity analysis to measure potential changes in the market value of Merck’s investments and debt from a change in interest rates indicated that a one percentage point increase in interest rates at December 31, 2012 and 2011 would have positively affected the net aggregate market value of these instruments by $1.2 billion each year. A one percentage point decrease at December 31, 2012 and 2011 would have negatively affected the net aggregate market value by $1.4 billion each year. The fair value of Merck’s debt was determined using pricing models reflecting one percentage point shifts in the appropriate yield curves. The fair values of Merck’s investments were determined using a combination of pricing and duration models.

Critical Accounting Policies

The Company’s consolidated financial statements are prepared in conformity with GAAP and, accordingly, include certain amounts that are based on management’s best estimates and judgments. Estimates are used when accounting for amounts recorded in connection with mergers and acquisitions, including initial fair value determinations of assets and liabilities, primarily IPR&D and other intangible assets, as well as subsequent fair value measurement. Additionally, estimates are used in determining such items as provisions for sales discounts and returns, depreciable and amortizable lives, recoverability of inventories, including those produced in preparation for product launches, amounts recorded for contingencies, environmental liabilities and other reserves, pension and other postretirement benefit plan assumptions, share-based compensation assumptions, restructuring costs, impairments of long-lived assets (including intangible assets and goodwill) and investments, and taxes on income. Because of the uncertainty inherent in such estimates, actual results may differ from these estimates. Application of the following accounting policies result in accounting estimates having the potential for the most significant impact on the financial statements.

Mergers and Acquisitions

In a business combination, the acquisition method of accounting requires that the assets acquired and liabilities assumed be recorded as of the date of the merger or acquisition at their respective fair values with limited exceptions. Assets acquired and liabilities assumed in a business combination that arise from contingencies are recognized at fair value if fair value can reasonably be estimated. If the acquisition date fair value of an asset acquired or liability assumed that arises from a contingency cannot be determined, the asset or liability is recognized if probable and reasonably estimable; if these criteria are not met, no asset or liability is recognized. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Accordingly, the Company may be required to value assets at fair value measures that do not reflect the Company's intended use of those assets. Any excess of the purchase price (consideration transferred) over the estimated fair values of net assets acquired is recorded as goodwill. Transaction costs and costs to restructure the acquired company are expensed as incurred. The operating results of the acquired business are reflected in the Company's consolidated financial statements after the date of the merger or acquisition. If the Company determines the assets acquired do not meet the definition of a business under the acquisition method of accounting, the transaction will be accounted for as an acquisition of assets rather than a business combination and, therefore, no goodwill will be recorded. The fair values of intangible assets, including acquired IPR&D, are determined utilizing information available near the merger or acquisition date based on expectations and assumptions that are deemed reasonable by management. Given the considerable judgment involved in determining fair values, the Company typically obtains assistance from third-party valuation specialists for significant items. Amounts allocated to acquired IPR&D are capitalized and accounted for as indefinite-lived intangible assets, subject to impairment testing until completion or abandonment of the projects. Upon successful completion of each project, Merck will make a separate determination as to the then useful life of the asset and begin amortization. The judgments made in determining estimated fair values assigned to assets acquired and liabilities assumed in a business combination, as well as asset lives, can materially affect the Company's results of operations.

The fair values of identifiable intangible assets related to currently marketed products and product rights are primarily determined by using an "income approach" through which fair value is estimated based on each asset's discounted projected net cash flows. The Company's estimates of market participant net cash flows consider historical and projected pricing, margins and expense levels; the performance of competing products where applicable; relevant industry and therapeutic area growth drivers and factors; current and expected trends in technology and product life cycles; the time and investment that will be required to develop products and technologies; the ability to obtain marketing and regulatory approvals; the ability to manufacture and commercialize the products; the extent and timing of potential new product introductions by the Company's competitors; and the life of each asset's underlying patent, if any. The net cash flows are then probability-adjusted where appropriate to consider the uncertainties associated with the underlying assumptions, as well as the risk profile of the net cash flows utilized in the valuation. The probability-adjusted future net cash flows of each product are then discounted to present value utilizing an appropriate discount rate.

The fair values of identifiable intangible assets related to IPR&D are determined using an income approach, through which fair value is estimated based on each asset's probability-adjusted future net cash flows, which reflect the different stages of development of each product and the associated probability of successful completion. The net cash flows are then discounted to present value using an appropriate discount rate.

Revenue Recognition

Revenues from sales of products are recognized at the time of delivery when title and risk of loss passes to the customer. Recognition of revenue also requires reasonable assurance of collection of sales proceeds and completion of all performance obligations. Domestically, sales discounts are issued to customers as direct discounts at the point-of-sale or indirectly through an intermediary wholesaler, known as chargebacks, or indirectly in the form of rebates. Additionally, sales are generally made with a limited right of return under certain conditions. Revenues are recorded net of provisions for sales discounts and returns, which are established at the time of sale. In addition, revenues are recorded net of time value of money discounts for customers for which collection of accounts receivable is expected to be in excess of one year.

The provision for aggregate indirect customer discounts covers chargebacks and rebates. Chargebacks are discounts that occur when a contracted customer purchases directly through an intermediary wholesaler. The contracted customer generally purchases product at its contracted price plus a mark-up from the wholesaler. The wholesaler, in turn, charges the Company back for the difference between the price initially paid by the wholesaler and the contract price paid to the wholesaler by the customer. The provision for chargebacks is based on expected sell-through levels by the Company's wholesale customers to contracted customers, as well as estimated wholesaler inventory levels. Rebates are amounts owed based upon definitive contractual agreements or legal requirements with private sector and public sector (Medicaid and Medicare Part D) benefit providers, after the final dispensing of the product by a pharmacy to a benefit plan participant. The provision is based on expected payments, which are driven by patient usage and contract performance by the benefit provider customers.

The Company uses historical customer segment mix, adjusted for other known events, in order to estimate the expected provision. Amounts accrued for aggregate indirect customer discounts are evaluated on a quarterly basis through comparison of information provided by the wholesalers, health maintenance organizations, pharmacy benefit managers and other customers to the amounts accrued. Adjustments are recorded when trends or significant events indicate that a change in the estimated provision is appropriate.

The Company continually monitors its provision for aggregate indirect customer discounts. There were no material adjustments to estimates associated with the aggregate indirect customer discount provision in 2012, 2011 or 2010.

Summarized information about changes in the aggregate indirect customer discount accrual is as follows:

($ in millions)	**2012**	2011
Balance January 1	**$ 1,824**	$ 1,307
Current provision	**5,694**	5,392
Adjustments to prior years	**89**	81
Payments	**(5,734)**	(4,956)
Balance December 31	**$ 1,873**	$ 1,824

Accruals for chargebacks are reflected as a direct reduction to accounts receivable and accruals for rebates as current liabilities. The accrued balances relative to these provisions included in *Accounts receivable* and *Accrued and other current liabilities* were $120 million and $1.8 billion, respectively, at December 31, 2012 and were $87 million and $1.7 billion, respectively, at December 31, 2011.

The Company maintains a returns policy that allows its U.S. pharmaceutical customers to return product within a specified period prior to and subsequent to the expiration date (generally, three to six months before and 12 months after product expiration). The estimate of the provision for returns is based upon historical experience with actual returns. Additionally, the Company considers factors such as levels of inventory in the distribution channel, product dating and expiration period, whether products have been discontinued, entrance in the market of additional generic competition, changes in formularies or launch of over-the-counter products, among others. The product returns provision for U.S. pharmaceutical sales was approximately 1.0% of U.S. net pharmaceutical sales in 2012, 2011 and 2010.

Through its distribution programs with U.S. wholesalers, the Company encourages wholesalers to align purchases with underlying demand and maintain inventories below specified levels. The terms of the programs allow the wholesalers to earn fees upon providing visibility into their inventory levels, as well as by achieving certain performance parameters such as inventory management, customer service levels, reducing shortage claims and reducing product returns. Information provided through the wholesaler distribution programs includes items such as sales trends, inventory on-hand, on-order quantity and product returns.

Wholesalers generally provide only the above mentioned data to the Company, as there is no regulatory requirement to report lot level information to manufacturers, which is the level of information needed to determine the remaining shelf life and original sale date of inventory. Given current wholesaler inventory levels, which are generally less than a month, the Company believes that collection of order lot information across all wholesale customers would have limited use in estimating sales discounts and returns.

Inventories Produced in Preparation for Product Launches

The Company capitalizes inventories produced in preparation for product launches sufficient to support estimated initial market demand. Typically, capitalization of such inventory does not begin until the related product candidates are in Phase III clinical trials and are considered to have a high probability of regulatory approval. The Company monitors the status of each respective product within the regulatory approval process; however, the Company generally does not disclose specific timing for regulatory approval. If the Company is aware of any specific risks or contingencies other than the normal regulatory approval process or if there are any specific issues identified during the research process relating to safety, efficacy, manufacturing, marketing or labeling, the related inventory would generally not be capitalized. Expiry dates of the inventory are affected by the stage of completion. The Company manages the levels of inventory at each stage to optimize the shelf life of the inventory in relation to anticipated market demand in order to avoid product expiry issues. For inventories that are capitalized, anticipated future sales and shelf lives support the realization of the inventory value as the inventory shelf life is sufficient to meet initial product launch requirements. Inventories produced in preparation for product launches capitalized at December 31, 2012 and 2011 were $196 million and $127 million, respectively.

Contingencies and Environmental Liabilities

The Company is involved in various claims and legal proceedings of a nature considered normal to its business, including product liability, intellectual property and commercial litigation, as well as additional matters such as antitrust actions. (See Note 11 to the consolidated financial statements.) The Company records accruals for contingencies when it is probable that a liability has been incurred and the amount can be reasonably estimated. These accruals are adjusted periodically as assessments change or additional information becomes available. For product liability claims, a portion of the overall accrual is actuarially determined and considers such factors as past experience, number of claims reported and estimates of claims incurred but not yet reported. Individually significant contingent losses are accrued when probable and reasonably estimable.

Legal defense costs expected to be incurred in connection with a loss contingency are accrued when probable and reasonably estimable. Some of the significant factors considered in the review of these legal defense reserves are as follows: the actual costs incurred by the Company; the development of the Company’s legal defense strategy and structure in light of the scope of its litigation; the number of cases being brought against the Company; the costs and outcomes of completed trials and the most current information regarding anticipated timing, progression, and related costs of pre-trial activities and trials in the associated litigation. The amount of legal defense reserves as of December 31, 2012 and 2011 of approximately $260 million and $240 million, respectively, represents the Company’s best estimate of the minimum amount of defense costs to be incurred in connection with its outstanding litigation; however, events such as additional trials and other events that could arise in the course of its litigation could affect the ultimate amount of legal defense costs to be incurred by the Company. The Company will continue to monitor its legal defense costs and review the adequacy of the associated reserves and may determine to increase the reserves at any time in the future if, based upon the factors set forth, it believes it would be appropriate to do so.

The Company and its subsidiaries are parties to a number of proceedings brought under the Comprehensive Environmental Response, Compensation and Liability Act, commonly known as Superfund, and other federal and state equivalents. When a legitimate claim for contribution is asserted, a liability is initially accrued based upon the estimated transaction costs to manage the site. Accruals are adjusted as site investigations, feasibility studies and related cost assessments of remedial techniques are completed, and as the extent to which other potentially responsible parties who may be jointly and severally liable can be expected to contribute is determined.

The Company is also remediating environmental contamination resulting from past industrial activity at certain of its sites and takes an active role in identifying and providing for these costs. In the past, Merck performed a worldwide survey to assess all sites for potential contamination resulting from past industrial activities. Where assessment indicated that physical investigation was warranted, such investigation was performed, providing a better evaluation of the need for remedial action. Where such need was identified, remedial action was then initiated. As definitive information became available during the course of investigations and/or remedial efforts at each site, estimates were refined and accruals were established or adjusted accordingly. These estimates and related accruals continue to be refined annually.

The Company believes that there are no compliance issues associated with applicable environmental laws and regulations that would have a material adverse effect on the Company. Expenditures for remediation and environmental liabilities were $14 million in 2012, and are estimated at $84 million in the aggregate for the years 2013 through 2017. In management's opinion, the liabilities for all environmental matters that are probable and reasonably estimable have been accrued and totaled $145 million and $171 million at December 31, 2012 and 2011, respectively. These liabilities are undiscounted, do not consider potential recoveries from other parties and will be paid out over the periods of remediation for the applicable sites, which are expected to occur primarily over the next 15 years. Although it is not possible to predict with certainty the outcome of these matters, or the ultimate costs of remediation, management does not believe that any reasonably possible expenditures that may be incurred in excess of the liabilities accrued should exceed $112 million in the aggregate. Management also does not believe that these expenditures should result in a material adverse effect on the Company's financial position, results of operations, liquidity or capital resources for any year.

Share-Based Compensation

The Company expenses all share-based payment awards to employees, including grants of stock options, over the requisite service period based on the grant date fair value of the awards. The Company determines the fair value of certain share-based awards using the Black-Scholes option-pricing model which uses both historical and current market data to estimate the fair value. This method incorporates various assumptions such as the risk-free interest rate, expected volatility, expected dividend yield and expected life of the options.

Pensions and Other Postretirement Benefit Plans

Net periodic benefit cost for pension and other postretirement benefit plans totaled $509 million in 2012, $665 million in 2011 and $696 million in 2010. The decline in net periodic benefit cost for pension and other postretirement benefit plans in 2012 as compared with 2011 and 2010 is largely attributable to the benefit plan design changes approved in December 2011 (see Note 14 to the consolidated financial statements). Pension and other postretirement benefit plan information for financial reporting purposes is calculated using actuarial assumptions including a discount rate for plan benefit obligations and an expected rate of return on plan assets.

The Company reassesses its benefit plan assumptions on a regular basis. For both the pension and other postretirement benefit plans, the discount rate is evaluated on measurement dates and modified to reflect the prevailing market rate of a portfolio of high-quality fixed-income debt instruments that would provide the future cash flows needed to pay the benefits included in the benefit obligation as they come due. At December 31, 2012, the discount rates for the Company's U.S. pension and other postretirement benefit plans ranged from 3.00% to 4.20% compared with a range of 4.00% to 5.00% at December 31, 2011.

The expected rate of return for both the pension and other postretirement benefit plans represents the average rate of return to be earned on plan assets over the period the benefits included in the benefit obligation are to be paid. In developing the expected rate of return, the Company considers long-term compound annualized returns of historical market data as well as actual returns on the Company's plan assets. Using this reference information, the Company develops forward-looking return expectations for each asset category and a weighted-average expected long-term rate of return for a target portfolio allocated across these investment categories. The expected portfolio performance reflects the contribution of active management as appropriate. As a result of this analysis, for 2013, the Company's expected rate of return will range from 6.00% to 8.75% compared to a range of 5.75% to 8.75% in 2012 for its U.S. pension and other postretirement benefit plans.

The Company has established investment guidelines for its U.S. pension and other postretirement plans to create an asset allocation that is expected to deliver a rate of return sufficient to meet the long-term obligation of each plan, given an acceptable level of risk. The target investment portfolio of the Company's U.S. pension and other postretirement benefit plans is allocated 45% to 60% in U.S. equities, 20% to 30% in international equities, 15% to 25% in fixed-income investments, and up to 8% in cash and other investments. The portfolio's equity weighting is consistent with the long-term nature of the plans' benefit obligations. The expected annual standard deviation of returns of the target portfolio, which approximates 13%, reflects both the equity allocation and the diversification benefits among the asset classes in which the portfolio invests. For non-U.S. pension plans, the targeted investment portfolio varies based on the duration of pension liabilities and local government rules and regulations. Although a significant percentage of plan assets are invested in U.S. equities, concentration risk is mitigated through the use of strategies that are diversified within management guidelines.

Actuarial assumptions are based upon management's best estimates and judgment. A reasonably possible change of plus (minus) 25 basis points in the discount rate assumption, with other assumptions held constant, would have an estimated $67 million favorable (unfavorable) impact on its net periodic benefit cost. A reasonably possible change of plus (minus) 25 basis points in the expected rate of return assumption, with other assumptions held constant, would have an estimated $34 million favorable (unfavorable) impact on its net periodic benefit cost. Required funding obligations for 2013 relating to the Company's pension and other postretirement benefit plans are not expected to be material. The preceding hypothetical changes in the discount rate and expected rate of return assumptions would not impact the Company's funding requirements.

Net loss amounts, which reflect experience differentials primarily relating to differences between expected and actual returns on plan assets as well as the effects of changes in actuarial assumptions, are recorded as a component of *AOCI*. Expected returns for pension plans are based on a calculated market-related value of assets. Under this methodology, asset gains/losses resulting from actual returns that differ from the Company's expected returns are recognized in the market-related value of assets ratably over a five-year period. Also, net loss amounts in *AOCI* in excess of certain thresholds are amortized into net periodic benefit cost over the average remaining service life of employees. Amortization of net losses for the Company's U.S. plans at December 31, 2012 is expected to increase net periodic benefit cost by approximately $7 million annually from 2013 through 2017.

Restructuring Costs

Restructuring costs have been recorded in connection with restructuring programs designed to reduce the cost structure, increase efficiency and enhance competitiveness. As a result, the Company has made estimates and judgments regarding its future plans, including future termination benefits and other exit costs to be incurred when the restructuring actions take place. When accruing these costs, the Company will recognize the amount within a range of costs that is the best estimate within the range. When no amount within the range is a better estimate than any other amount, the Company recognizes the minimum amount within the range. In connection with these actions, management also assesses the recoverability of long-lived assets employed in the business. In certain instances, asset lives have been shortened based on changes in the expected useful lives of the affected assets. Severance and other related costs are reflected within *Restructuring costs*. Asset-related charges are reflected within *Materials and production* costs, *Marketing and administrative* expenses and *Research and development* expenses depending upon the nature of the asset.

Impairments of Long-Lived Assets

The Company assesses changes in economic, regulatory and legal conditions and makes assumptions regarding estimated future cash flows in evaluating the value of the Company's property, plant and equipment, goodwill and other intangible assets.

The Company periodically evaluates whether current facts or circumstances indicate that the carrying values of its long-lived assets to be held and used may not be recoverable. If such circumstances are determined to exist, an estimate of the undiscounted future cash flows of these assets, or appropriate asset groupings, is compared to the carrying value to determine whether an impairment exists. If the asset is determined to be impaired, the loss is measured based on the difference between the asset's fair value and its carrying value. If quoted market prices are not available, the Company will estimate fair value using a discounted value of estimated future cash flows approach.

Goodwill represents the excess of the consideration transferred over the fair value of net assets of businesses purchased and is assigned to reporting units. The Company tests its goodwill for impairment on at least an annual basis, or more frequently if impairment indicators exist, by first assessing qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. Some of the factors considered in the assessment include general macro economic conditions, conditions specific to the industry and market, cost factors which could have a significant effect on earnings or cash flows, the overall financial performance of the reporting unit, and whether there have been sustained declines in the Company's share price. Additionally, the Company evaluates the extent to which the fair value exceeded the carrying value of the reporting unit at the last date a valuation was performed. If the Company concludes it is more likely than not that the fair value of a reporting unit is less than its carrying amount, a quantitative fair value test is performed.

Other acquired intangibles (excluding IPR&D) are recorded at fair value, assigned an estimated useful life, and are amortized primarily on a straight-line basis over their estimated useful lives. When events or circumstances warrant a review, the Company will assess recoverability from future operations using pretax undiscounted cash flows derived from the lowest appropriate asset groupings. Impairments are recognized in operating results to the extent that the carrying value of the intangible asset exceeds its fair value, which is determined based on the net present value of estimated future cash flows.

IPR&D represents the fair value assigned to incomplete research projects that the Company acquires through business combinations which, at the time of acquisition, have not reached technological feasibility. The amounts are capitalized and accounted for as indefinite-lived intangible assets, subject to impairment testing until completion or abandonment of the project. The Company tests IPR&D for impairment at least annually, or more frequently if impairment indicators exist, through a one-step test that compares the fair value of the IPR&D intangible asset with its carrying value. For impairment testing purposes, the Company may combine separately recorded IPR&D intangible assets into one unit of account based on the relevant facts and circumstances. Generally, the Company will combine IPR&D intangible assets for testing purposes if they operate as a single asset and are essentially inseparable. If the fair value is less than the carrying amount, an impairment loss is recognized within the Company's operating results.

Impairments of Investments

The Company reviews its investments for impairments based on the determination of whether the decline in market value of the investment below the carrying value is other-than-temporary. The Company considers available evidence in evaluating potential impairments of its investments, including the duration and extent to which fair value is less than cost and, for equity securities, the Company's ability and intent to hold the investments. For debt securities, an other-than-temporary impairment has occurred if the Company does not expect to recover the entire amortized cost basis of the debt security. If the Company does not intend to sell the impaired debt security, and it is not more likely than not it will be required to sell the debt security before the recovery of its amortized cost basis, the amount of the other-than-temporary impairment recognized in earnings is limited to the portion attributed to credit loss. The remaining portion of the other-than-temporary impairment related to other factors is recognized in *OCI*.

Taxes on Income

The Company's effective tax rate is based on pretax income, statutory tax rates and tax planning opportunities available in the various jurisdictions in which the Company operates. An estimated effective tax rate for a year is applied to the Company's quarterly operating results. In the event that there is a significant unusual or one-time item recognized, or expected to be recognized, in the Company's quarterly operating results, the tax attributable to that item would be separately calculated and recorded at the same time as the unusual or one-time item. The Company considers the resolution of prior year tax matters to be such items. Significant judgment is required in determining the Company's tax provision and in evaluating its tax positions. The recognition and measurement of a tax position is based on management's best judgment given the facts, circumstances and information available at the reporting date. The Company evaluates tax positions to determine whether the benefits of tax positions are more likely than not of being sustained upon audit based on the technical merits of the tax position. For tax positions that are more likely than not of being sustained upon audit, the Company recognizes the largest amount of the benefit that is greater than 50% likely of being realized upon ultimate settlement in the financial statements. For tax positions that are not more likely than not of being sustained upon audit, the Company does not recognize any portion of the benefit in the financial statements. If the more likely than not threshold is not met in the period for which a tax position is taken, the Company may subsequently recognize the benefit of that tax position if the tax matter is effectively settled, the statute of limitations expires, or if the more likely than not threshold is met in a subsequent period. (See Note 16 to the consolidated financial statements.)

Tax regulations require items to be included in the tax return at different times than the items are reflected in the financial statements. Timing differences create deferred tax assets and liabilities. Deferred tax assets generally represent items that can be used as a tax deduction or credit in the tax return in future years for which the Company has already recorded the tax benefit in the financial statements. The Company establishes valuation allowances for its deferred tax assets when the amount of expected future taxable income is not likely to support the use of the deduction or credit. Deferred tax liabilities generally represent tax expense recognized in the financial statements for which payment has been deferred or expense for which the Company has already taken a deduction on the tax return, but has not yet recognized as expense in the financial statements. At December 31, 2012, foreign earnings of $53.4 billion have been retained indefinitely by subsidiary companies for reinvestment; therefore, no provision has been made for income taxes that would be payable upon the distribution of such earnings and it would not be practicable to determine the amount of the related unrecognized deferred income tax liability.

Recently Issued Accounting Standards

In July 2012, the FASB issued amended guidance that simplifies how an entity tests indefinite-lived intangibles for impairment. The amended guidance will allow companies to first assess qualitative factors to determine whether it is more-likely-than-not that an indefinite-lived intangible asset is impaired as a basis for determining whether it is necessary to perform the quantitative impairment test. The updated guidance is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012, with early adoption permitted. The effect of adoption on the Company's financial position and results of operations is not expected to be material.

Cautionary Factors That May Affect Future Results

This report and other written reports and oral statements made from time to time by the Company may contain so-called "forward-looking statements," all of which are based on management's current expectations and are subject to risks and uncertainties which may cause results to differ materially from those set forth in the statements. One can identify these forward-looking statements by their use of words such as "anticipates," "expects," "plans," "will," "estimates," "forecasts," "projects" and other words of similar meaning. One can also identify them by the fact that they do not relate strictly to historical or current facts. These statements are likely to address the Company's growth strategy, financial results, product development, product approvals, product potential and development programs. One must carefully consider any such statement and should understand that many factors could cause actual results to differ materially from the Company's forward-looking statements. These factors include inaccurate assumptions and a broad variety of other risks and uncertainties, including some that are known and some that are not. No forward-looking statement can be guaranteed and actual future results may vary materially.

The Company does not assume the obligation to update any forward-looking statement. One should carefully evaluate such statements in light of factors, including risk factors, described in the Company's filings with the Securities and Exchange Commission, especially on this Form 10-K and Forms 10-Q and 8-K. In Item 1A. "Risk Factors" of this annual report on Form 10-K the Company discusses in more detail various important risk factors that could cause actual results to differ from expected or historic results. The Company notes these factors for investors as permitted by the Private Securities Litigation Reform Act of 1995. One should understand that it is not possible to predict or identify all such factors. Consequently, the reader should not consider any such list to be a complete statement of all potential risks or uncertainties.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk.

The information required by this Item is incorporated by reference to the discussion under "Financial Instruments Market Risk Disclosures" in Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations."

Item 8. Financial Statements and Supplementary Data.

(a) Financial Statements

The consolidated balance sheet of Merck & Co., Inc. and subsidiaries as of December 31, 2012 and 2011, and the related consolidated statements of income, of comprehensive income, of equity and of cash flows for each of the three years in the period ended December 31, 2012, the notes to consolidated financial statements, and the report dated February 26, 2013 of PricewaterhouseCoopers LLP, independent registered public accounting firm, are as follows:

Consolidated Statement of Income
Merck & Co., Inc. and Subsidiaries
Years Ended December 31
($ in millions except per share amounts)

	2012	2011	2010
Sales	**$47,267**	$48,047	$45,987
Costs, Expenses and Other			
Materials and production	**16,446**	16,871	18,396
Marketing and administrative	**12,776**	13,733	13,125
Research and development	**8,168**	8,467	11,111
Restructuring costs	**664**	1,306	985
Equity income from affiliates	**(642)**	(610)	(587)
Other (income) expense, net	**1,116**	946	1,304
	38,528	40,713	44,334
Income Before Taxes	**8,739**	7,334	1,653
Taxes on Income	**2,440**	942	671
Net Income	**6,299**	6,392	982
Less: Net Income Attributable to Noncontrolling Interests	**131**	120	121
Net Income Attributable to Merck & Co., Inc.	**$ 6,168**	$ 6,272	$ 861
Basic Earnings per Common Share Attributable to Merck & Co., Inc. Common Shareholders	**$ 2.03**	$ 2.04	$ 0.28
Earnings per Common Share Assuming Dilution Attributable to Merck & Co., Inc. Common Shareholders	**$ 2.00**	$ 2.02	$ 0.28

Consolidated Statement of Comprehensive Income
Merck & Co., Inc. and Subsidiaries
Years Ended December 31
($ in millions)

	2012	2011	2010
Net Income Attributable to Merck & Co., Inc.	**$ 6,168**	$6,272	$ 861
Other Comprehensive (Loss) Income Net of Taxes:			
Net unrealized (loss) gain on derivatives, net of reclassifications	**(101)**	(37)	83
Net unrealized gain (loss) on investments, net of reclassifications	**52**	(10)	(2)
Benefit plan net (loss) gain and prior service (credit) cost, net of amortization	**(1,321)**	(303)	426
Cumulative translation adjustment	**(180)**	434	(956)
	(1,550)	84	(449)
Comprehensive Income Attributable to Merck & Co., Inc.	**$ 4,618**	$6,356	$ 412

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

Consolidated Balance Sheet

Merck & Co., Inc. and Subsidiaries

December 31

($ in millions except per share amounts)

	2012	2011
Assets		
Current Assets		
Cash and cash equivalents	**$ 13,451**	$ 13,531
Short-term investments	**2,690**	1,441
Accounts receivable (net of allowance for doubtful accounts of $163 in 2012 and $131 in 2011)	**7,672**	8,261
Inventories (excludes inventories of $1,606 in 2012 and $1,379 in 2011 classified in Other assets — see Note 7)	**6,535**	6,254
Deferred income taxes and other current assets	**4,509**	3,694
Total current assets	**34,857**	33,181
Investments	**7,305**	3,458
Property, Plant and Equipment (at cost)		
Land	**591**	623
Buildings	**13,196**	12,733
Machinery, equipment and office furnishings	**17,188**	16,919
Construction in progress	**2,440**	2,198
	33,415	32,473
Less: accumulated depreciation	**17,385**	16,176
	16,030	16,297
Goodwill	**12,134**	12,155
Other Intangibles, Net	**29,083**	34,302
Other Assets	**6,723**	5,735
	$106,132	$105,128
Liabilities and Equity		
Current Liabilities		
Loans payable and current portion of long-term debt	**4,315**	1,990
Trade accounts payable	**1,753**	2,023
Accrued and other current liabilities	**9,737**	10,170
Income taxes payable	**1,200**	781
Dividends payable	**1,343**	1,281
Total current liabilities	**18,348**	16,245
Long-Term Debt	**16,254**	15,525
Deferred Income Taxes and Noncurrent Liabilities	**16,067**	16,415
Merck & Co., Inc. Stockholders' Equity		
Common stock, $0.50 par value		
Authorized — 6,500,000,000 shares		
Issued — 3,577,103,522 shares in 2012 and 2011	**1,788**	1,788
Other paid-in capital	**40,646**	40,663
Retained earnings	**39,985**	38,990
Accumulated other comprehensive loss	**(4,682)**	(3,132)
	77,737	78,309
Less treasury stock, at cost: 550,468,221 shares in 2012; 536,109,713 shares in 2011	**24,717**	23,792
Total Merck & Co., Inc. stockholders' equity	**53,020**	54,517
Noncontrolling Interests	**2,443**	2,426
Total equity	**55,463**	56,943
	$106,132	$105,128

The accompanying notes are an integral part of this consolidated financial statement.

Consolidated Statement of Equity

Merck & Co., Inc. and Subsidiaries

Years Ended December 31

($ in millions except per share amounts)

	Common Stock	Other Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Non-controlling Interests	Total
Balance January 1, 2010	$1,781	$39,683	$41,405	$(2,767)	$(21,044)	$2,427	$61,485
Net income attributable to Merck & Co., Inc.	—	—	861	—	—	—	861
Other comprehensive loss, net of tax	—	—	—	(449)	—	—	(449)
Cash dividends declared on common stock ($1.52 per share)	—	—	(4,730)	—	—	—	(4,730)
Mandatory conversion of 6% convertible preferred stock	2	132	—	—	—	—	134
Treasury stock shares purchased	—	—	—	—	(1,593)	—	(1,593)
Net income attributable to noncontrolling interests	—	—	—	—	—	121	121
Distributions attributable to noncontrolling interests	—	—	—	—	—	(119)	(119)
Share-based compensation plans and other	5	886	—	—	204	—	1,095
Balance December 31, 2010	1,788	40,701	37,536	(3,216)	(22,433)	2,429	56,805
Net income attributable to Merck & Co., Inc.	—	—	6,272	—	—	—	6,272
Other comprehensive income, net of tax	—	—	—	84	—	—	84
Cash dividends declared on common stock ($1.56 per share)	—	—	(4,818)	—	—	—	(4,818)
Treasury stock shares purchased	—	—	—	—	(1,921)	—	(1,921)
Net income attributable to noncontrolling interests	—	—	—	—	—	120	120
Distributions attributable to noncontrolling interests	—	—	—	—	—	(120)	(120)
Share-based compensation plans and other	—	(38)	—	—	562	(3)	521
Balance December 31, 2011	1,788	40,663	38,990	(3,132)	(23,792)	2,426	56,943
Net income attributable to Merck & Co., Inc.	**—**	**—**	**6,168**	**—**	**—**	**—**	**6,168**
Other comprehensive loss, net of tax	**—**	**—**	**—**	**(1,550)**	**—**	**—**	**(1,550)**
Cash dividends declared on common stock ($1.69 per share)	**—**	**—**	**(5,173)**	**—**	**—**	**—**	**(5,173)**
Treasury stock shares purchased	**—**	**—**	**—**	**—**	**(2,591)**	**—**	**(2,591)**
Net income attributable to noncontrolling interests	**—**	**—**	**—**	**—**	**—**	**131**	**131**
Distributions attributable to noncontrolling interests	**—**	**—**	**—**	**—**	**—**	**(120)**	**(120)**
Share-based compensation plans and other	**—**	**(17)**	**—**	**—**	**1,666**	**6**	**1,655**
Balance December 31, 2012	**$1,788**	**$40,646**	**$39,985**	**$(4,682)**	**$(24,717)**	**$2,443**	**$55,463**

The accompanying notes are an integral part of this consolidated financial statement.

Consolidated Statement of Cash Flows

Merck & Co., Inc. and Subsidiaries

Years Ended December 31

($ in millions)

	2012	2011	2010
Cash Flows from Operating Activities			
Net income	**$ 6,299**	$ 6,392	$ 982
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	**6,978**	7,427	7,381
Intangible asset impairment charges	**200**	705	2,441
Gain on disposition of interest in equity method investment	**—**	(136)	—
Gain on AstraZeneca LP asset option exercise	**—**	—	(443)
Equity income from affiliates	**(642)**	(610)	(587)
Dividends and distributions from equity affiliates	**291**	216	324
Deferred income taxes	**669**	(1,537)	(1,092)
Share-based compensation	**335**	369	509
Other	**28**	323	377
Net changes in assets and liabilities:			
Accounts receivable	**349**	(1,168)	(1,089)
Inventories	**(482)**	(678)	1,990
Trade accounts payable	**(302)**	182	124
Accrued and other current liabilities	**(717)**	1,444	35
Income taxes payable	**(34)**	(277)	128
Noncurrent liabilities	**(1,747)**	(7)	(98)
Other	**(1,203)**	(262)	(160)
Net Cash Provided by Operating Activities	**10,022**	12,383	10,822
Cash Flows from Investing Activities			
Capital expenditures	**(1,954)**	(1,723)	(1,678)
Purchases of securities and other investments	**(12,841)**	(7,325)	(7,197)
Proceeds from sales of securities and other investments	**7,783**	6,149	4,561
Proceeds from sale of interest in equity method investment	**—**	175	—
Acquisitions of businesses, net of cash acquired	**—**	(373)	(256)
Dispositions of businesses, net of cash divested	**—**	323	—
Proceeds from AstraZeneca LP asset option exercise	**—**	—	647
Decrease in restricted assets	**34**	—	276
Other	**173**	(116)	150
Net Cash Used in Investing Activities	**(6,805)**	(2,890)	(3,497)
Cash Flows from Financing Activities			
Net change in short-term borrowings	**624**	1,076	90
Payments on debt	**(22)**	(1,547)	(1,341)
Proceeds from issuance of debt	**2,562**	—	1,999
Purchases of treasury stock	**(2,591)**	(1,921)	(1,593)
Dividends paid to stockholders	**(5,116)**	(4,691)	(4,734)
Other dividends paid	**(120)**	(120)	(119)
Proceeds from exercise of stock options	**1,310**	321	363
Other	**86**	(22)	(106)
Net Cash Used in Financing Activities	**(3,267)**	(6,904)	(5,441)
Effect of Exchange Rate Changes on Cash and Cash Equivalents	**(30)**	42	(295)
Net (Decrease) Increase in Cash and Cash Equivalents	**(80)**	2,631	1,589
Cash and Cash Equivalents at Beginning of Year	**13,531**	10,900	9,311
Cash and Cash Equivalents at End of Year	**$ 13,451**	$13,531	$10,900

The accompanying notes are an integral part of this consolidated financial statement.

Notes to Consolidated Financial Statements

Merck & Co., Inc. and Subsidiaries

($ in millions except per share amounts)

1. Nature of Operations

Merck & Co., Inc. ("Merck" or "the Company") is a global health care company that delivers innovative health solutions through its prescription medicines, vaccines, biologic therapies, animal health, and consumer care products, which it markets directly and through its joint ventures. The Company's operations are principally managed on a products basis and are comprised of four operating segments, which are the Pharmaceutical, Animal Health, Consumer Care and Alliances segments, and one reportable segment, which is the Pharmaceutical segment. The Pharmaceutical segment includes human health pharmaceutical and vaccine products marketed either directly by the Company or through joint ventures. Human health pharmaceutical products consist of therapeutic and preventive agents, generally sold by prescription, for the treatment of human disorders. The Company sells these human health pharmaceutical products primarily to drug wholesalers and retailers, hospitals, government agencies and managed health care providers such as health maintenance organizations, pharmacy benefit managers and other institutions. Vaccine products consist of preventive pediatric, adolescent and adult vaccines, primarily administered at physician offices. The Company sells these human health vaccines primarily to physicians, wholesalers, physician distributors and government entities. The Company also has animal health operations that discover, develop, manufacture and market animal health products, including vaccines, which the Company sells to veterinarians, distributors and animal producers. Additionally, the Company has consumer care operations that develop, manufacture and market over-the-counter, foot care and sun care products, which are sold through wholesale and retail drug, food chain and mass merchandiser outlets, as well as club stores and specialty channels.

2. Summary of Accounting Policies

Principles of Consolidation — The consolidated financial statements include the accounts of the Company and all of its subsidiaries in which a controlling interest is maintained. Intercompany balances and transactions are eliminated. Controlling interest is determined by majority ownership interest and the absence of substantive third-party participating rights or, in the case of variable interest entities, by majority exposure to expected losses, residual returns or both. For those consolidated subsidiaries where Merck ownership is less than 100%, the outside shareholders' interests are shown as *Noncontrolling interests* in equity. Investments in affiliates over which the Company has significant influence but not a controlling interest, such as interests in entities owned equally by the Company and a third party that are under shared control, are carried on the equity basis.

Mergers and Acquisitions — In a business combination, the acquisition method of accounting requires that the assets acquired and liabilities assumed be recorded as of the date of the merger or acquisition at their respective fair values with limited exceptions. Assets acquired and liabilities assumed in a business combination that arise from contingencies are recognized at fair value if fair value can reasonably be estimated. If the acquisition date fair value of an asset acquired or liability assumed that arises from a contingency cannot be determined, the asset or liability is recognized if probable and reasonably estimable; if these criteria are not met, no asset or liability is recognized. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Accordingly, the Company may be required to value assets at fair value measures that do not reflect the Company's intended use of those assets. Any excess of the purchase price (consideration transferred) over the estimated fair values of net assets acquired is recorded as goodwill. Transaction costs and costs to restructure the acquired company are expensed as incurred. The operating results of the acquired business are reflected in the Company's consolidated financial statements after the date of the merger or acquisition. If the Company determines the assets acquired do not meet the definition of a business under the acquisition method of accounting, the transaction will be accounted for as an acquisition of assets rather than a business combination and, therefore, no goodwill will be recorded.

Foreign Currency Translation — The net assets of international subsidiaries where the local currencies have been determined to be the functional currencies are translated into U.S. dollars using current exchange rates. The U.S. dollar effects that arise from translating the net assets of these subsidiaries at changing rates are recorded in the foreign currency translation account, which is included in *Accumulated other comprehensive income (loss)* ("*AOCI*") and reflected as a separate component of equity. For those subsidiaries that operate in highly inflationary economies and for those subsidiaries where the U.S. dollar has been determined to be the functional currency, non-monetary foreign currency assets and liabilities are translated using historical rates, while monetary assets and liabilities are translated at current rates, with the U.S. dollar effects of rate changes included in *Other (income) expense, net*.

Cash Equivalents — Cash equivalents are comprised of certain highly liquid investments with original maturities of less than three months.

Inventories — Inventories are valued at the lower of cost or market. The cost of a substantial majority of domestic pharmaceutical and vaccine inventories is determined using the last-in, first-out ("LIFO") method for both financial reporting and tax purposes. The cost of all other inventories is determined using the first-in, first-out ("FIFO") method. Inventories consist of currently marketed products and certain products awaiting regulatory approval. In evaluating the recoverability of inventories produced in preparation for product launches, the Company considers the likelihood that revenue will be obtained from the future sale of the related inventory together with the status of the product within the regulatory approval process.

Investments — Investments in marketable debt and equity securities classified as available-for-sale are reported at fair value. Fair values of the Company's investments are determined using quoted market prices in active markets for identical assets or liabilities or quoted prices for similar assets or liabilities or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Changes in fair value that are considered temporary are reported net of tax in *Other Comprehensive Income* ("*OCI*"). For declines in the fair value of equity securities that are considered other-than-temporary, impairment losses are charged to *Other (income) expense, net*. The Company considers available evidence in evaluating potential impairments of its investments, including the duration and extent to which fair value is less than cost and, for equity securities, the Company's ability and intent to hold the investments. For debt securities, an other-than-temporary impairment has occurred if the Company does not expect to recover the entire amortized cost basis of the debt security. If the Company does not intend to sell the impaired debt security, and it is not more likely than not it will be required to sell the debt security before the recovery of its amortized cost basis, the amount of the other-than-temporary impairment recognized in earnings, recorded in *Other (income) expense, net*, is limited to the portion attributed to credit loss. The remaining portion of the other-than-temporary impairment related to other factors is recognized in *OCI*. Realized gains and losses for both debt and equity securities are included in *Other (income) expense, net*.

Revenue Recognition — Revenues from sales of products are recognized at the time of delivery when title and risk of loss passes to the customer. Recognition of revenue also requires reasonable assurance of collection of sales proceeds and completion of all performance obligations. Domestically, sales discounts are issued to customers as direct discounts at the point-of-sale or indirectly through an intermediary wholesaler, known as chargebacks, or indirectly in the form of rebates. Additionally, sales are generally made with a limited right of return under certain conditions. Revenues are recorded net of provisions for sales discounts and returns, which are established at the time of sale. In addition, revenues are recorded net of time value of money discounts if collection of accounts receivable is expected to be in excess of one year. Accruals for chargebacks are reflected as a direct reduction to accounts receivable and accruals for rebates are recorded as current liabilities. The accrued balances relative to the provisions for chargebacks and rebates included in *Accounts receivable* and *Accrued and other current liabilities* were $120 million and $1.8 billion, respectively, at December 31, 2012 and $87 million and $1.7 billion, respectively, at December 31, 2011.

The Company recognizes revenue from the sales of vaccines to the Federal government for placement into vaccine stockpiles in accordance with Securities and Exchange Commission ("SEC") Interpretation, *Commission Guidance Regarding Accounting for Sales of Vaccines and BioTerror Countermeasures to the Federal Government for Placement into the Pediatric Vaccine Stockpile or the Strategic National Stockpile*.

Depreciation — Depreciation is provided over the estimated useful lives of the assets, principally using the straight-line method. For tax purposes, accelerated tax methods are used. The estimated useful lives primarily range from 10 to 50 years for *Buildings*, and from 3 to 15 years for *Machinery, equipment and office furnishings*.

Software Capitalization — The Company capitalizes certain costs incurred in connection with obtaining or developing internal-use software including external direct costs of material and services, and payroll costs for employees directly involved with the software development. Capitalized software costs are included in *Property, plant and equipment* and amortized beginning when the software project is substantially complete and the asset is ready for its intended use. Capitalized software costs associated with the Company's multi-year implementation of an enterprise-wide resource planning system are being amortized over 6 to 10 years. At December 31, 2012 and 2011, there was approximately $385 million and $390 million, respectively, of remaining unamortized capitalized software costs associated with this initiative. All other capitalized software costs are being amortized over periods ranging from 3 to 5 years. Costs incurred during the preliminary project stage and post-implementation stage, as well as maintenance and training costs, are expensed as incurred.

Goodwill — Goodwill represents the excess of the consideration transferred over the fair value of net assets of businesses purchased. Goodwill is assigned to reporting units and evaluated for impairment on at least an annual basis, or more frequently if impairment indicators exist, by first assessing qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If the Company concludes it is more likely than not that the fair value of a reporting unit is less than its carrying amount, a quantitative fair value test is performed. Based upon the Company's most recent annual impairment test completed as of October 1, 2012, the Company concluded goodwill was not impaired.

Acquired Intangibles — Acquired intangibles include products and product rights, tradenames and patents, which are recorded at fair value, assigned an estimated useful life, and are amortized primarily on a straight-line basis over their estimated useful lives ranging from 3 to 40 years (see Note 8). When events or circumstances warrant a review, the Company will assess recoverability of acquired intangibles from future operations using pretax undiscounted cash flows derived from the lowest appropriate asset groupings. Impairments are recognized in operating results to the extent that the carrying value of the intangible asset exceeds its fair value, which is determined based on the net present value of estimated future cash flows.

In-Process Research and Development — In-process research and development ("IPR&D") represents the fair value assigned to incomplete research projects that the Company acquires through business combinations which, at the time of acquisition, have not reached technological feasibility. The amounts are capitalized and are accounted for as indefinite-lived intangible assets, subject to impairment testing until completion or abandonment of the projects. Upon successful completion of each project, Merck will make a determination as to the then useful life of the intangible asset, generally determined by the period in which substantially all of the cash flows are expected to be generated, and begin amortization. The Company tests IPR&D for impairment at least annually, or more frequently if impairment indicators exist, through a one-step test that compares the fair value of the IPR&D intangible asset with its carrying value. If the fair value is less than the carrying amount, an impairment loss is recognized in operating results.

Research and Development — Research and development is expensed as incurred. Upfront and milestone payments due to third parties in connection with research and development collaborations prior to regulatory approval are expensed as incurred. Payments due to third parties upon or subsequent to regulatory approval are capitalized and amortized over the shorter of the remaining license or product patent life. Nonrefundable advance payments for goods and services that will be used in future research and development activities are expensed when the activity has been performed or when the goods have been received rather than when the payment is made. Research and development expenses include restructuring costs in all periods and IPR&D impairment charges of $200 million, $587 million and $2.4 billion in 2012, 2011 and 2010, respectively.

Share-Based Compensation — The Company expenses all share-based payments to employees over the requisite service period based on the grant-date fair value of the awards.

Restructuring Costs — The Company records liabilities for costs associated with exit or disposal activities in the period in which the liability is incurred. In accordance with existing benefit arrangements, employee termination costs are accrued when the restructuring actions are probable and estimable. When accruing these costs, the Company will recognize the amount within a range of costs that is the best estimate within the range. When no amount within the range is a better estimate than any other amount, the Company recognizes the minimum amount within the range. Costs for one-time termination benefits in which the employee is required to render service until termination in order to receive the benefits are recognized ratably over the future service period.

Contingencies and Legal Defense Costs — The Company records accruals for contingencies and legal defense costs expected to be incurred in connection with a loss contingency when it is probable that a liability has been incurred and the amount can be reasonably estimated.

Taxes on Income — Deferred taxes are recognized for the future tax effects of temporary differences between financial and income tax reporting based on enacted tax laws and rates. The Company evaluates tax positions to determine whether the benefits of tax positions are more likely than not of being sustained upon audit based on the technical merits of the tax position. For tax positions that are more likely than not of being sustained upon audit, the Company recognizes the largest amount of the benefit that is greater than 50% likely of being realized upon ultimate settlement in the financial statements. For tax positions that are not more likely than not of being sustained upon audit, the Company does not recognize any portion of the benefit in the financial statements. The Company recognizes interest and penalties associated with uncertain tax positions as a component of *Taxes on income* in the Consolidated Statement of Income.

Use of Estimates — The consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States (“GAAP”) and, accordingly, include certain amounts that are based on management’s best estimates and judgments. Estimates are used when accounting for amounts recorded in connection with mergers and acquisitions, including initial fair value determinations of assets and liabilities, primarily IPR&D and other intangible assets, as well as subsequent fair value measurements. Additionally, estimates are used in determining such items as provisions for sales discounts and returns, depreciable and amortizable lives, recoverability of inventories, including those produced in preparation for product launches, amounts recorded for contingencies, environmental liabilities and other reserves, pension and other postretirement benefit plan assumptions, share-based compensation assumptions, restructuring costs, impairments of long-lived assets (including intangible assets and goodwill) and investments, and taxes on income. Because of the uncertainty inherent in such estimates, actual results may differ from these estimates.

Reclassifications — Certain reclassifications have been made to prior year amounts to conform to the current year presentation.

Recently Adopted Accounting Standards — During 2012, the Company retrospectively adopted amended guidance from the Financial Accounting Standards Board (the “FASB”) on the presentation of comprehensive income in financial statements. As a result of adopting this guidance, the Company has presented a separate Statement of Comprehensive Income. The adoption of this new guidance did not impact the Company’s financial position, results of operations or cash flows.

Recently Issued Accounting Standards — In July 2012, the FASB issued amended guidance that simplifies how an entity tests indefinite-lived intangibles for impairment. The amended guidance will allow companies to first assess qualitative factors to determine whether it is more-likely-than-not that an indefinite-lived intangible asset is impaired as a basis for determining whether it is necessary to perform the quantitative impairment test. The updated guidance is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012, with early adoption permitted. The effect of adoption on the Company’s financial position and results of operations is not expected to be material.

3. Restructuring

Merger Restructuring Program

In 2010, subsequent to the Merck and Schering-Plough Corporation (“Schering-Plough”) merger (the “Merger”), the Company commenced actions under a global restructuring program (the “Merger Restructuring Program”) in conjunction with the integration of the legacy Merck and legacy Schering-Plough businesses designed to optimize the cost structure of the combined company. These initial actions, which are expected to result in workforce reductions of approximately 17%, primarily reflect the elimination of positions in sales, administrative and headquarters organizations, as well as from the sale or closure of certain manufacturing and research and development sites and the consolidation of office facilities. In July 2011, the Company initiated further actions under the Merger Restructuring Program through which the Company expects to reduce its workforce measured at the time of the Merger by an additional 12% to 13% across the Company worldwide. A majority of the workforce reductions associated with these additional actions relate to manufacturing (including Animal Health), administrative and headquarters organizations. The Company will continue to hire employees in strategic growth areas of the business as necessary.

The Company recorded total pretax restructuring costs of $951 million in 2012, $1.8 billion in 2011 and $1.8 billion in 2010 related to this program. Since inception of the Merger Restructuring Program through December 31, 2012, Merck has recorded total pretax accumulated costs of approximately $6.1 billion and eliminated approximately 22,400 positions comprised of employee separations, as well as the elimination of contractors and vacant positions. The restructuring actions under the Merger Restructuring Program are expected to be substantially completed by the end of 2013, with the exception of certain actions, principally manufacturing-related. Subsequent to the Merger, the Company has rationalized a number of manufacturing sites worldwide. The remaining actions under this program will result in additional manufacturing facility rationalizations, which are expected to be substantially completed by 2016. The Company now expects the estimated total cumulative pretax costs for this program to be approximately $7.2 billion to $7.5 billion. The increase from original estimates primarily reflects accelerated depreciation related to additional facility closures identified during the Company's ongoing assessment of worldwide capacity requirements for its manufacturing, research and administrative facilities subsequent to the Merger, including the recently announced move of the Company's worldwide headquarters to Summit, New Jersey. The Company estimates that approximately two-thirds of the cumulative pretax costs relate to cash outlays, primarily related to employee separation expense. Approximately one-third of the cumulative pretax costs are non-cash, relating primarily to the accelerated depreciation of facilities to be closed or divested.

2008 Global Restructuring Program

In October 2008, Merck announced a global restructuring program (the "2008 Restructuring Program") to reduce its cost structure, increase efficiency, and enhance competitiveness. As part of the 2008 Restructuring Program, the Company expects to eliminate approximately 7,200 positions — 6,800 active employees and 400 vacancies — across the Company worldwide. Pretax restructuring costs of $48 million, $45 million and $176 million were recorded in 2012, 2011 and 2010, respectively, related to the 2008 Restructuring Program. Since inception of the 2008 Restructuring Program through December 31, 2012, Merck has recorded total pretax accumulated costs of $1.7 billion and eliminated approximately 6,400 positions comprised of employee separations and the elimination of contractors and vacant positions. The 2008 Restructuring Program was substantially completed in 2011, with the exception of certain manufacturing-related actions, which are expected to be completed by 2015, with the total cumulative pretax costs estimated to be up to $2.0 billion. The Company estimates that two-thirds of the cumulative pretax costs relate to cash outlays, primarily from employee separation expense. Approximately one-third of the cumulative pretax costs are non-cash, relating primarily to the accelerated depreciation of facilities to be closed or divested.

For segment reporting, restructuring charges are unallocated expenses.

The following table summarizes the charges related to Merger Restructuring Program and 2008 Restructuring Program activities by type of cost:

Year Ended December 31, 2012	Separation Costs	Accelerated Depreciation	Other	Total
Merger Restructuring Program				
Materials and production	**$ —**	**$ 92**	**$ 70**	**$ 162**
Marketing and administrative	**—**	**75**	**6**	**81**
Research and development	**—**	**53**	**4**	**57**
Restructuring costs	**497**	**—**	**154**	**651**
	497	**220**	**234**	**951**
2008 Restructuring Program				
Materials and production	**—**	**7**	**19**	**26**
Marketing and administrative	**—**	**8**	**1**	**9**
Restructuring costs	**(8)**	**—**	**21**	**13**
	(8)	**15**	**41**	**48**
	$ 489	**$235**	**$275**	**$ 999**
Year Ended December 31, 2011				
Merger Restructuring Program				
Materials and production	$ —	$282	$ 17	$ 299
Marketing and administrative	—	108	11	119
Research and development	—	151	(17)	134
Restructuring costs	1,117	—	177	1,294
	1,117	541	188	1,846
2008 Restructuring Program				
Materials and production	—	24	5	29
Research and development	—	4	—	4
Restructuring costs	(6)	—	18	12
	(6)	28	23	45
	$1,111	$569	$211	$1,891
Year Ended December 31, 2010				
Merger Restructuring Program				
Materials and production	$ —	$241	$ 74	$ 315
Marketing and administrative	—	145	2	147
Research and development	—	364	54	418
Restructuring costs	708	—	207	915
	708	750	337	1,795
2008 Restructuring Program				
Materials and production	—	67	25	92
Marketing and administrative	—	—	(3)	(3)
Research and development	—	10	—	10
Restructuring costs	60	—	17	77
	60	77	39	176
	$ 768	$827	$376	$1,971

Separation costs are associated with actual headcount reductions, as well as those headcount reductions which were probable and could be reasonably estimated. In 2012, 2011 and 2010 approximately 3,975, 6,880 and 11,410 positions, respectively, were eliminated under the Merger Restructuring Program and approximately 155, 450 and 890 positions, respectively, were eliminated under the 2008 Restructuring Program. These position eliminations were comprised of actual headcount reductions and the elimination of contractors and vacant positions.

Accelerated depreciation costs primarily relate to manufacturing, research and administrative facilities and equipment to be sold or closed as part of the programs. Accelerated depreciation costs represent the difference between the depreciation expense to be recognized over the revised useful life of the site, based upon the anticipated date the site will be closed or divested, and depreciation expense as determined utilizing the useful life prior to the restructuring actions. All of the sites have and will continue to operate up through the respective closure dates and, since future cash flows were sufficient to recover the respective book values, Merck was required to accelerate depreciation of the site assets rather than write them off immediately. Anticipated site closure dates, particularly related to manufacturing locations, have been and may continue to be adjusted to reflect changes resulting from regulatory or other factors.

Other activity in 2012, 2011 and 2010 includes $155 million, $72 million and $152 million, respectively, of asset abandonment, shut-down and other related costs and, in 2010, also includes approximately $65 million of contract termination costs. Additionally, other activity includes $35 million, $53 million and $88 million in 2012, 2011 and 2010, respectively, for other employee-related costs such as curtailment, settlement and termination charges associated with pension and other postretirement benefit plans (see Note 14) and share-based compensation costs. Other activity also reflects net pretax gains resulting from sales of facilities and related assets in 2012, 2011 and 2010 of $28 million, $10 million and $49 million, respectively.

Adjustments to the recorded amounts were not material in any period.

The following table summarizes the charges and spending relating to Merger Restructuring Program and 2008 Restructuring Program activities:

	Separation Costs	Accelerated Depreciation	Other	Total
Merger Restructuring Program				
Restructuring reserves January 1, 2011	$ 859	$ —	$ 64	$ 923
Expenses	1,117	541	188	1,846
(Payments) receipts, net	(832)	—	(245)	(1,077)
Non-cash activity	—	(541)	44	(497)
Restructuring reserves December 31, 2011	1,144	—	51	1,195
Expenses	**497**	**220**	**234**	**951**
(Payments) receipts, net	**(942)**	**—**	**(170)**	**(1,112)**
Non-cash activity	**—**	**(220)**	**(96)**	**(316)**
Restructuring reserves December 31, 2012[(1)]	**$ 699**	**$ —**	**$ 19**	**$ 718**
2008 Restructuring Program				
Restructuring reserves January 1, 2011	$ 196	$ —	$ —	$ 196
Expenses	(6)	28	23	45
(Payments) receipts, net	(64)	—	(21)	(85)
Non-cash activity	—	(28)	(2)	(30)
Restructuring reserves December 31, 2011	126	—	—	126
Expenses	**(8)**	**15**	**41**	**48**
(Payments) receipts, net	**(41)**	**—**	**(21)**	**(62)**
Non-cash activity	**—**	**(15)**	**(20)**	**(35)**
Restructuring reserves December 31, 2012[(1)]	**$ 77**	**$ —**	**$ —**	**$ 77**

(1) *The cash outlays associated with the Merger Restructuring Program are expected to be substantially completed by the end of 2013 with the exception of certain actions, principally manufacturing-related, which are expected to be substantially completed by 2016. The cash outlays associated with the remaining restructuring reserves for the 2008 Restructuring Program are primarily manufacturing-related and are expected to be completed by the end of 2015.*

Legacy Schering-Plough Program

Prior to the Merger, Schering-Plough commenced a Productivity Transformation Program which was designed to reduce and avoid costs and increase productivity. During 2011 and 2010, the Company recorded $20 million and $22 million, respectively, of accelerated depreciation costs included in *Materials and production* costs. In addition, *Restructuring costs* reflect a $7 million net gain in 2010 primarily related to the sale of a manufacturing facility. This program was substantially complete at the end of 2011.

4. Acquisitions, Divestitures, Research Collaborations and License Agreements

In October 2012, Merck and AiCuris entered into an exclusive licensing agreement which provides Merck with worldwide rights to develop and commercialize candidates in AiCuris' novel portfolio of investigational medicines targeting human cytomegalovirus ("HCMV"), including letermovir (MK-8228), an oral, late-stage antiviral candidate being investigated for the treatment and prevention of HCMV infection in transplant recipients. AiCuris received an upfront payment of €110 million (approximately $140 million), which the Company recorded as research and development expense, and is eligible for milestone payments of up to €332.5 million based on successful achievement of development, regulatory and commercialization goals for HCMV candidates, including letermovir, an additional back-up candidate as well as other Phase I candidates designed to act via an alternate mechanism. In addition, AiCuris will be entitled to receive royalty payments reflecting the advanced stage of the clinical program on any potential products that result from the agreement. Merck will be responsible for all development activities and costs. The agreement may be terminated by either party in the event of a material uncured breach or insolvency. The agreement may be terminated by Merck at any time in the event that any of the compounds licensed from AiCuris develop an adverse safety profile or any material adverse issue arises related to the development, efficacy or dosing regimen of any of the compounds, and/or in the event that certain patents are invalid and/or unenforceable in certain jurisdictions. Merck (i) may terminate the agreement with respect to certain compounds after successful completion of the first proof of concept clinical trial or (ii) must terminate the agreement with respect to certain compounds if Merck fails to minimally invest in such compounds. In addition, Merck may terminate the agreement as a whole at any time upon six months prior written notice at any time after completion of the first Phase III clinical trial for a compound. AiCuris may terminate the agreement in the event that Merck challenges any AiCuris patent covering the compounds licensed from AiCuris. Upon termination of the agreement, depending upon the circumstances, the parties have varying rights and obligations with respect to the continued development and commercialization of compounds and, in the case of termination for cause by Merck, certain royalty obligations.

In April 2012, the Company entered into an agreement with Endocyte, Inc. ("Endocyte") to develop and commercialize Endocyte's novel investigational therapeutic candidate vintafolide (MK-8109). Vintafolide is currently being evaluated in a Phase III clinical trial for folate-receptor positive platinum-resistant ovarian cancer (PROCEED) and a Phase II trial for non-small cell lung cancer. Under the agreement, Merck gained worldwide rights to develop and commercialize vintafolide. Endocyte received a $120 million upfront payment, which the Company recorded as research and development expense, and is eligible for milestone payments of up to $880 million based on the successful achievement of development, regulatory and commercialization goals for vintafolide for a total of six cancer indications. In addition, if vintafolide receives regulatory approval, Merck and Endocyte will share equally profits and losses in the United States. Endocyte will receive a royalty on sales of the product in the rest of the world. Endocyte has retained the right to co-promote vintafolide with Merck in the United States and Merck has the exclusive right to promote vintafolide in the rest of world. Endocyte will be responsible for the majority of funding and completion of the PROCEED trial. Merck will be responsible for all other development activities and development costs and have all decision rights for vintafolide. Merck has the right to terminate the agreement on 90 days notice. Merck and Endocyte both have the right to terminate the agreement due to the material breach or insolvency of the other party. Endocyte has the right to terminate the agreement in the event that Merck challenges an Endocyte patent right relating to vintafolide. Upon termination of the agreement, depending upon the circumstances, the parties have varying rights and obligations with respect to the continued development and commercialization of vintafolide and, in the case of termination for cause by Merck, certain royalty obligations and U.S. profit and loss sharing.

In May 2011, Merck completed the acquisition of Inspire Pharmaceuticals, Inc. ("Inspire"), a specialty pharmaceutical company focused on developing and commercializing ophthalmic products. Under the terms of the merger agreement, Merck acquired all outstanding shares of common stock of Inspire at a price of $5.00 per share in cash for a total of approximately $420 million. The transaction was accounted for as an acquisition of a business; accordingly, the assets acquired and liabilities assumed were recorded at their respective fair values as of the acquisition date. The determination of fair value requires management to make significant estimates and assumptions. In connection with the acquisition, substantially all of the purchase price was allocated to Inspire's product and product right intangible assets and related deferred tax liabilities, a deferred tax asset relating to Inspire's net operating loss carryforwards, and goodwill. This transaction closed on May 16, 2011, and accordingly, the results of operations of the acquired business have been included in the Company's results of operations since the acquisition date. Pro forma financial information has not been included because Inspire's historical financial results are not significant when compared with the Company's financial results.

In March 2011, the Company sold the Merck BioManufacturing Network, a provider of contract manufacturing and development services for the biopharmaceutical industry and wholly owned by Merck, to Fujifilm Corporation ("Fujifilm"). Under the terms of the agreement, Fujifilm purchased all of the equity interests in two Merck subsidiaries which together owned all of the assets of the Merck BioManufacturing Network comprising facilities located in Research Triangle Park, North Carolina and Billingham, United Kingdom. As part of the agreement with Fujifilm, Merck has committed to purchase certain development and manufacturing services at fair value from Fujifilm over a three-year period following the closing of the transaction. The transaction resulted in a gain of $127 million in 2011 reflected in *Other (income) expense, net*.

5. Collaborative Arrangements

The Company continues its strategy of establishing external alliances to complement its substantial internal research capabilities, including research collaborations, as well as licensing preclinical and clinical compounds and technology platforms to drive both near- and long-term growth. The Company supplements its internal research with a licensing and external alliance strategy focused on the entire spectrum of collaborations from early research to late-stage compounds, as well as new technologies across a broad range of therapeutic areas. These arrangements often include upfront payments and royalty or profit share payments, contingent upon the occurrence of certain future events linked to the success of the asset in development, as well as expense reimbursements or payments to the third party.

Cozaar/Hyzaar

In 1989, Merck and E.I. duPont de Nemours and Company ("DuPont") agreed to form a long-term research and marketing collaboration to develop a class of therapeutic agents for high blood pressure and heart disease, discovered by DuPont, called angiotensin II receptor antagonists, which include *Cozaar* and *Hyzaar*. In return, Merck provided DuPont marketing rights in the United States and Canada to its prescription medicines, *Sinemet* and *Sinemet CR* (the Company has since regained global marketing rights to *Sinemet* and *Sinemet CR*). Pursuant to a 1994 agreement with DuPont, the Company had an exclusive licensing agreement to market *Cozaar* and *Hyzaar* in return for royalties and profit share payments to DuPont. This agreement terminated on December 31, 2012 in accordance with its terms. As a result of the termination of the agreement, Merck no longer shares profits from, or marketing costs related to, the sale of *Cozaar* and *Hyzaar* with DuPont. However, under a separate agreement, the trademarks for *Cozaar* and *Hyzaar* were permanently transferred to Merck in exchange for Merck paying a trademark royalty to DuPont based on sales of *Cozaar* and *Hyzaar* for a period of 10 years.

Remicade/Simponi

In 1998, a subsidiary of Schering-Plough entered into a licensing agreement with Centocor Ortho Biotech Inc. ("Centocor"), a Johnson & Johnson ("J&J") company, to market *Remicade,* which is prescribed for the treatment of inflammatory diseases. In 2005, Schering-Plough's subsidiary exercised an option under its contract with Centocor for license rights to develop and commercialize *Simponi*, a fully human monoclonal antibody. The Company had exclusive marketing rights to both products outside the United States, Japan and certain other Asian markets. In December 2007, Schering-Plough and Centocor revised their distribution agreement regarding the development, commercialization and distribution of both *Remicade* and *Simponi*, extending the Company's rights to exclusively market *Remicade* to match the duration of the Company's exclusive marketing rights for *Simponi*. In addition, Schering-Plough and Centocor agreed to share certain development costs relating to *Simponi*'s auto-injector delivery system. On October 6, 2009, the European Commission approved *Simponi* as a treatment for rheumatoid arthritis and other immune system disorders in two presentations — a novel auto-injector and a prefilled syringe. As a result, the Company's marketing rights for both products extend for 15 years from the first commercial sale of *Simponi* in the European Union (the "EU") following the receipt of pricing and reimbursement approval within the EU.

In April 2011, Merck and J&J reached an agreement to amend the agreement governing the distribution rights to *Remicade* and *Simponi*. Under the terms of the amended distribution agreement, Merck relinquished marketing rights for *Remicade* and *Simponi* to J&J in territories including Canada, Central and South America, the Middle East, Africa and Asia Pacific effective July 1, 2011. Merck retained exclusive marketing rights throughout Europe, Russia and Turkey (the "Retained Territories"). In addition, beginning July 1, 2011, all profits derived from Merck's exclusive distribution of the two products in the Retained Territories are being equally divided between Merck and J&J. J&J also received a one-time payment from Merck of $500 million in April 2011, which the Company recorded as a charge to *Other (income) expense, net* in 2011.

6. Financial Instruments

Derivative Instruments and Hedging Activities

The Company manages the impact of foreign exchange rate movements and interest rate movements on its earnings, cash flows and fair values of assets and liabilities through operational means and through the use of various financial instruments, including derivative instruments.

A significant portion of the Company's revenues and earnings in foreign affiliates is exposed to changes in foreign exchange rates. The objectives and accounting related to the Company's foreign currency risk management program, as well as its interest rate risk management activities are discussed below.

Foreign Currency Risk Management

The Company has established revenue hedging, balance sheet risk management and net investment hedging programs to protect against volatility of future foreign currency cash flows and changes in fair value caused by volatility in foreign exchange rates.

The objective of the revenue hedging program is to reduce the potential for longer-term unfavorable changes in foreign exchange rates to decrease the U.S. dollar value of future cash flows derived from foreign currency denominated sales, primarily the euro and Japanese yen. To achieve this objective, the Company will hedge a portion of its forecasted foreign currency denominated third-party and intercompany distributor entity sales that are expected to occur over its planning cycle, typically no more than three years into the future. The Company will layer in hedges over time, increasing the portion of third-party and intercompany distributor entity sales hedged as it gets closer to the expected date of the forecasted foreign currency denominated sales. The portion of sales hedged is based on assessments of cost-benefit profiles that consider natural offsetting exposures, revenue and exchange rate volatilities and correlations, and the cost of hedging instruments. The hedged anticipated sales are a specified component of a portfolio of similarly denominated foreign currency-based sales transactions, each of which responds to the hedged currency risk in the same manner. The Company manages its anticipated transaction exposure principally with purchased local currency put options, which provide the Company with a right, but not an obligation, to sell foreign currencies in the future at a predetermined price. If the U.S. dollar strengthens relative to the currency of the hedged anticipated sales, total changes in the options' cash flows offset the decline in the expected future U.S. dollar equivalent cash flows of the hedged foreign currency sales. Conversely, if the U.S. dollar weakens, the options' value reduces to zero, but the Company benefits from the increase in the U.S. dollar equivalent value of the anticipated foreign currency cash flows.

In connection with the Company's revenue hedging program, a purchased collar option strategy may be utilized. With a purchased collar option strategy, the Company writes a local currency call option and purchases a local currency put option. As compared to a purchased put option strategy alone, a purchased collar strategy reduces the upfront costs associated with purchasing puts through the collection of premium by writing call options. If the U.S. dollar weakens relative to the currency of the hedged anticipated sales, the purchased put option value of the collar strategy reduces to zero and the Company benefits from the increase in the U.S. dollar equivalent value of its anticipated foreign currency cash flows, however this benefit would be capped at the strike level of the written call. If the U.S. dollar strengthens relative to the currency of the hedged anticipated sales, the written call option value of the collar strategy reduces to zero and the changes in the purchased put cash flows of the collar strategy would offset the decline in the expected future U.S. dollar equivalent cash flows of the hedged foreign currency sales.

The Company may also utilize forward contracts in its revenue hedging program. If the U.S. dollar strengthens relative to the currency of the hedged anticipated sales, the increase in the fair value of the forward contracts offsets the decrease in the expected future U.S. dollar cash flows of the hedged foreign currency sales. Conversely, if the U.S. dollar weakens, the decrease in the fair value of the forward contracts offsets the increase in the value of the anticipated foreign currency cash flows.

The fair values of these derivative contracts are recorded as either assets (gain positions) or liabilities (loss positions) in the Consolidated Balance Sheet. Changes in the fair value of derivative contracts are recorded each period in either current earnings or *OCI*, depending on whether the derivative is designated as part of a hedge transaction and, if so, the type of hedge transaction. For derivatives that are designated as cash flow hedges, the effective portion of the unrealized gains or losses on these contracts is recorded in *AOCI* and reclassified into *Sales* when the hedged anticipated revenue is recognized. The hedge relationship is highly effective and hedge ineffectiveness has been *de minimis*. For those derivatives which are not designated as cash flow hedges, but serve as economic hedges of forecasted sales, unrealized gains or losses are recorded in *Sales* each period. The cash flows from both designated and non-designated contracts are reported as operating activities in the Consolidated Statement of Cash Flows. The Company does not enter into derivatives for trading or speculative purposes.

The primary objective of the balance sheet risk management program is to mitigate the exposure of foreign currency denominated net monetary assets of foreign subsidiaries where the U.S. dollar is the functional currency from the effects of volatility in foreign exchange. In these instances, Merck principally utilizes forward exchange contracts, which enable the Company to buy and sell foreign currencies in the future at fixed exchange rates and economically offset the consequences of changes in foreign exchange from the monetary assets. Merck routinely enters into contracts to offset the effects of exchange on exposures denominated in developed country currencies, primarily the euro and Japanese yen. For exposures in developing country currencies, the Company will enter into forward contracts to partially offset the effects of exchange on exposures when it is deemed economical to do so based on a cost-benefit analysis that considers the magnitude of the exposure, the volatility of the exchange rate and the cost of the hedging instrument. The Company will also minimize the effect of exchange on monetary assets and liabilities by managing operating activities and net asset positions at the local level.

Monetary assets and liabilities denominated in a currency other than the functional currency of a given subsidiary are remeasured at spot rates in effect on the balance sheet date with the effects of changes in spot rates reported in *Other (income) expense, net*. The forward contracts are not designated as hedges and are marked to market through *Other (income) expense, net*. Accordingly, fair value changes in the forward contracts help mitigate the changes in the value of the remeasured assets and liabilities attributable to changes in foreign currency exchange rates, except to the extent of the spot-forward differences. These differences are not significant due to the short-term nature of the contracts, which typically have average maturities at inception of less than one year.

The Company also uses forward exchange contracts to hedge its net investment in foreign operations against movements in exchange rates. The forward contracts are designated as hedges of the net investment in a foreign operation. The Company hedges a portion of the net investment in certain of its foreign operations and measures ineffectiveness based upon changes in spot foreign exchange rates. The effective portion of the unrealized gains or losses on these contracts is recorded in foreign currency translation adjustment within *OCI*, and remains in *AOCI* until either the sale or complete or substantially complete liquidation of the subsidiary. The cash flows from these contracts are reported as investing activities in the Consolidated Statement of Cash Flows.

Foreign exchange risk is also managed through the use of foreign currency debt. The Company's senior unsecured euro-denominated notes have been designated as, and are effective as, economic hedges of the net investment in a foreign operation. Accordingly, foreign currency transaction gains or losses due to spot rate fluctuations on the euro-denominated debt instruments are included in foreign currency translation adjustment within *OCI*. Included in the cumulative translation adjustment are pretax losses of $31 million in 2012 and pretax gains of $6 million in 2011 and $277 million in 2010 from the euro-denominated notes.

Interest Rate Risk Management

The Company may use interest rate swap contracts on certain investing and borrowing transactions to manage its net exposure to interest rate changes and to reduce its overall cost of borrowing. The Company does not use leveraged swaps and, in general, does not leverage any of its investment activities that would put principal capital at risk.

During 2011, the Company terminated pay-floating, receive-fixed interest rate swap contracts designated as fair value hedges of fixed-rate notes in which the notional amounts match the amount of the hedged fixed-rate notes. These swaps effectively converted certain of its fixed-rate notes to floating-rate instruments. The interest rate swap contracts were designated hedges of the fair value changes in the notes attributable to changes in the benchmark London Interbank Offered Rate ("LIBOR") swap rate. As a result of the swap terminations, the Company received $288 million in cash, which included $43 million in accrued interest. The corresponding $245 million basis adjustment of the debt associated with the terminated interest rate swap contracts was deferred and is being amortized as a reduction of interest expense over the respective term of the notes. The cash flows from these contracts are reported as operating activities in the Consolidated Statement of Cash Flows.

Presented in the table below is the fair value of derivatives on a gross basis segregated between those derivatives that are designated as hedging instruments and those that are not designated as hedging instruments as of December 31:

		2012			2011		
		Fair Value of Derivative			Fair Value of Derivative		
	Balance Sheet Caption	**Asset**	**Liability**	**U.S. Dollar Notional**	Asset	Liability	U.S. Dollar Notional
Derivatives Designated as Hedging Instruments							
Foreign exchange contracts (current)	Deferred income taxes and other current assets	**$281**	**$ —**	**$ 6,646**	$196	$ —	$ 3,727
Foreign exchange contracts (non-current)	Other assets	**387**	**—**	**5,989**	420	—	4,956
Foreign exchange contracts (current)	Accrued and other current liabilities	**—**	**13**	**938**	—	53	1,718
Foreign exchange contracts (non-current)	Deferred income taxes and noncurrent liabilities	**—**	**—**	**—**	—	1	104
		$668	**$ 13**	**$13,573**	$616	$ 54	$10,505
Derivatives Not Designated as Hedging Instruments							
Foreign exchange contracts (current)	Deferred income taxes and other current assets	**$ 55**	**$ —**	**$ 4,548**	$139	$ —	$ 5,306
Foreign exchange contracts (non-current)	Other assets	**8**	**—**	**232**	—	—	—
Foreign exchange contracts (current)	Accrued and other current liabilities	**—**	**216**	**8,203**	—	54	5,013
		$ 63	**$216**	**$12,983**	$139	$ 54	$10,319
		$731	**$229**	**$26,556**	$755	$108	$20,824

The table below provides information on the location and pretax gain or loss amounts for derivatives that are: (i) designated in a fair value hedging relationship, (ii) designated in a cash flow hedging relationship, (iii) designated in a foreign currency net investment hedging relationship and (iv) not designated in a hedging relationship:

Years Ended December 31	**2012**	2011	2010
Derivatives designated in fair value hedging relationships			
Interest rate swap contracts			
Amount of gain recognized in *Other (income) expense, net* on derivatives	**$ —**	$(196)	$ (23)
Amount of loss recognized in *Other (income) expense, net* on hedged item	**—**	196	23
Derivatives designated in foreign currency cash flow hedging relationships			
Foreign exchange contracts			
Amount of loss reclassified from *AOCI* to *Sales*	**50**	85	7
Amount of loss (gain) recognized in *OCI* on derivatives	**204**	143	(103)
Derivatives designated in foreign currency net investment hedging relationships			
Foreign exchange contracts			
Amount of gain recognized in *Other (income) expense, net* on derivatives[(1)]	**(20)**	(10)	(1)
Amount of (gain) loss recognized in *OCI* on deriviatives	**(208)**	122	24
Derivatives not designated in a hedging relationship			
Foreign exchange contracts			
Amount of loss (gain) recognized in *Other (income) expense, net* on derivatives[(2)]	**382**	(113)	(33)
Amount of loss (gain) recognized in *Sales*	**30**	—	(81)

[(1)] *There was no ineffectiveness on the hedge. Represents the amount excluded from hedge effectiveness testing.*

[(2)] *These derivative contracts mitigate changes in the value of remeasured foreign currency denominated monetary assets and liabilities attributable to changes in foreign currency exchange rates.*

At December 31, 2012, the Company estimates $138 million of pretax net unrealized losses on derivatives maturing within the next 12 months that hedge foreign currency denominated sales over that same period will be reclassified from *AOCI* to *Sales*. The amount ultimately reclassified to *Sales* may differ as foreign exchange rates change. Realized gains and losses are ultimately determined by actual exchange rates at maturity.

Investments in Debt and Equity Securities

Information on available-for-sale investments at December 31 is as follows:

	2012				2011			
			Gross Unrealized				Gross Unrealized	
	Fair Value	**Amortized Cost**	**Gains**	**Losses**	Fair Value	Amortized Cost	Gains	Losses
Corporate notes and bonds	**$ 5,063**	**$ 5,013**	**$52**	**$ (2)**	$2,032	$2,024	$16	$ (8)
Commercial paper	**2,150**	**2,150**	**—**	**—**	1,029	1,029	—	—
U.S. government and agency securities	**1,206**	**1,204**	**2**	**—**	1,021	1,018	3	—
Asset-backed securities	**837**	**835**	**3**	**(1)**	292	292	1	(1)
Mortgage-backed securities	**435**	**436**	**2**	**(3)**	223	223	1	(1)
Foreign government bonds	**108**	**107**	**1**	**—**	72	72	—	—
Other debt securities	**—**	**—**	**—**	**—**	3	1	2	—
Equity securities	**403**	**370**	**33**	**—**	397	383	14	—
	$10,202	**$10,115**	**$93**	**$ (6)**	$5,069	$5,042	$37	$(10)

Available-for-sale debt securities included in *Short-term investments* totaled $2.7 billion at December 31, 2012. Of the remaining debt securities, $6.4 billion mature within five years. At December 31, 2012 and 2011, there were no debt securities pledged as collateral.

Fair Value Measurements

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The Company uses a fair value hierarchy which maximizes the use of observable inputs and minimizes the use of unobservable inputs when measuring fair value. There are three levels of inputs used to measure fair value with Level 1 having the highest priority and Level 3 having the lowest:

Level 1 — Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 — Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 — Unobservable inputs that are supported by little or no market activity. Level 3 assets are those whose values are determined using pricing models, discounted cash flow methodologies, or similar techniques with significant unobservable inputs, as well as instruments for which the determination of fair value requires significant judgment or estimation.

If the inputs used to measure the financial assets and liabilities fall within more than one level described above, the categorization is based on the lowest level input that is significant to the fair value measurement of the instrument.

Financial Assets and Liabilities Measured at Fair Value on a Recurring Basis

Financial assets and liabilities measured at fair value on a recurring basis at December 31 are summarized below:

	Fair Value Measurements Using				Fair Value Measurements Using			
	Quoted Prices In Active Markets for Identical Assets (Level 1)	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Total**	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
		2012				2011		
Assets								
Investments								
Corporate notes and bonds	**$ —**	**$ 5,063**	**$—**	**$ 5,063**	$ —	$2,032	$—	$2,032
Commercial paper	**—**	**2,150**	**—**	**2,150**	—	1,029	—	1,029
U.S. government and agency securities	**—**	**1,206**	**—**	**1,206**	—	1,021	—	1,021
Asset-backed securities[(1)]	**—**	**837**	**—**	**837**	—	292	—	292
Mortgage-backed securities[(1)]	**—**	**435**	**—**	**435**	—	223	—	223
Foreign government bonds	**—**	**108**	**—**	**108**	—	72	—	72
Equity securities	**196**	**—**	**—**	**196**	205	22	—	227
Other debt securities	**—**	**—**	**—**	**—**	—	3	—	3
	196	**9,799**	**—**	**9,995**	205	4,694	—	4,899
Other assets								
Securities held for employee compensation	**169**	**38**	**—**	**207**	170	—	—	170
Derivative assets[(2)]								
Purchased currency options	**—**	**546**	**—**	**546**	—	613	—	613
Forward exchange contracts	**—**	**185**	**—**	**185**	—	142	—	142
	—	**731**	**—**	**731**	—	755	—	755
Total assets	**$365**	**$10,568**	**$—**	**$10,933**	$375	$5,449	$—	$5,824
Liabilities								
Derivative liabilities[(2)]								
Forward exchange contracts	**$ —**	**$ 216**	**$—**	**$ 216**	$ —	$ 107	$—	$ 107
Written currency options	**—**	**13**	**—**	**13**	—	1	—	1
Total liabilities	**$ —**	**$ 229**	**$—**	**$ 229**	$ —	$ 108	$—	$ 108

(1) *Primarily all of the asset-backed securities are highly-rated (Standard & Poor's rating of AAA and Moody's Investors Service rating of Aaa), secured primarily by credit card, auto loan, and home equity receivables, with weighted-average lives of primarily 5 years or less. Mortgage-backed securities represent AAA-rated securities issued or unconditionally guaranteed as to payment of principal and interest by U.S. government agencies.*

(2) *The fair value determination of derivatives includes the impact of the credit risk of counterparties to the derivatives and the Company's own credit risk, the effects of which were not significant.*

There were no transfers between Level 1 and Level 2 during 2012. As of December 31, 2012, *Cash and cash equivalents* of $13.5 billion included $12.5 billion of cash equivalents (which would be considered Level 2 in the fair value hierarchy).

Other Fair Value Measurements

Some of the Company's financial instruments, such as cash and cash equivalents, receivables and payables, are reflected in the balance sheet at carrying value, which approximates fair value due to their short-term nature.

The estimated fair value of loans payable and long-term debt (including current portion) at December 31, 2012 was $22.8 billion compared with a carrying value of $20.6 billion and at December 31, 2011 was $19.5 billion compared with a carrying value of $17.5 billion. Fair value was estimated using recent observable market prices and would be considered Level 2 in the fair value hierarchy.

Concentrations of Credit Risk

On an ongoing basis, the Company monitors concentrations of credit risk associated with corporate and government issuers of securities and financial institutions with which it conducts business. Credit exposure limits are established to limit a concentration with any single issuer or institution. Cash and investments are placed in instruments that meet high credit quality standards, as specified in the Company's investment policy guidelines. Approximately 50% of the Company's cash and cash equivalents are invested in five highly rated money market funds.

The majority of the Company's accounts receivable arise from product sales in the United States and Europe and are primarily due from drug wholesalers and retailers, hospitals, government agencies, managed health care providers and pharmacy benefit managers. The Company monitors the financial performance and creditworthiness of its customers so that it can properly assess and respond to changes in their credit profile. The Company also continues to monitor economic conditions, including the volatility associated with international sovereign economies, and associated impacts on the financial markets and its business, taking into consideration the global economic downturn and the sovereign debt issues in certain European countries. The Company continues to monitor the credit and economic conditions within Greece, Italy, Spain and Portugal, among other members of the EU. These economic conditions, as well as inherent variability of timing of cash receipts, have resulted in, and may continue to result in, an increase in the average length of time that it takes to collect accounts receivable outstanding. As such, time value of money discounts have been recorded for those customers for which collection of accounts receivable is expected to be in excess of one year. At December 31, 2012, the Company classified approximately $475 million of accounts receivable not expected to be collected within one year to *Other assets*. The Company does not expect to have write-offs or adjustments to accounts receivable which would have a material adverse effect on its financial position, liquidity or results of operations.

As of December 31, 2012, the Company's accounts receivable in Greece, Italy, Spain and Portugal totaled approximately $1.1 billion. Of this amount, hospital and public sector receivables were approximately $800 million in the aggregate, of which approximately 18%, 37%, 36% and 9% related to Greece, Italy, Spain and Portugal, respectively. As of December 31, 2012, the Company's total accounts receivable outstanding for more than one year were approximately $200 million, of which approximately 70% related to accounts receivable in Greece, Italy, Spain and Portugal, mostly comprised of hospital and public sector receivables.

During 2012, the Company collected approximately $60 million of accounts receivable from the government of Portugal, which pertained to accounts receivable outstanding from 2011 and prior. Also during 2012, the Company collected approximately $500 million of accounts receivable in connection with the Spanish government's debt stabilization/stimulus plan. In addition, the Company completed non-recourse factorings of approximately $230 million in 2012 of hospital and public sector accounts receivable in Italy.

As previously disclosed, the Company received zero coupon bonds from the Greek government in settlement of 2007-2009 receivables related to certain government sponsored institutions. The Company had recorded impairment charges to reduce the bonds to fair value. During 2011, the Company sold a portion of these bonds and the remainder was sold during 2012. During 2011 and 2012, the Company has continued to receive payments on 2011 and 2010 Greek hospital and public sector receivables.

Additionally, the Company continues to expand in the emerging markets. Payment terms in these markets tend to be longer, resulting in an increase in accounts receivable balances in certain of these markets.

The Company's customers with the largest accounts receivable balances are: Cardinal Health, Inc., McKesson Corporation, AmerisourceBergen Corporation, Alliance Healthcare, Zuellig Pharma Ltd. (Asia Pacific) and Grupo Casa Saba (Mexico), which represented, in aggregate, approximately one-fourth of total accounts receivable at December 31, 2012. The Company monitors the creditworthiness of its customers to which it grants credit terms in the normal course of business. Bad debts have been minimal. The Company does not normally require collateral or other security to support credit sales.

Derivative financial instruments are executed under International Swaps and Derivatives Association master agreements. The master agreements with several of the Company's financial institution counterparties also include credit support annexes. These annexes contain provisions that require collateral to be exchanged depending on the value of the derivative assets and liabilities, the Company's credit rating, and the credit rating of the counterparty. As of December 31, 2012 and 2011, the Company had received cash collateral of $305 million and $327 million, respectively, from various counterparties and the obligation to return such collateral is recorded in *Accrued and other current liabilities*. The Company had not advanced any cash collateral to counterparties as of December 31, 2012 or 2011.

7. Inventories

Inventories at December 31 consisted of:

	2012	2011
Finished goods	**$1,924**	$1,983
Raw materials and work in process	**5,921**	5,396
Supplies	**244**	297
Total (approximates current cost)	**8,089**	7,676
Increase (reduction) to LIFO costs	**52**	(43)
	$8,141	$7,633
Recognized as:		
Inventories	**$6,535**	$6,254
Other assets	**1,606**	1,379

Inventories valued under the LIFO method comprised approximately 26% and 27% of inventories at December 31, 2012 and 2011, respectively. Amounts recognized as *Other assets* are comprised almost entirely of raw materials and work in process inventories. At December 31, 2012 and 2011, these amounts included $1.4 billion and $1.3 billion, respectively, of inventories not expected to be sold within one year. In addition, these amounts included $196 million and $127 million at December 31, 2012 and 2011, respectively, of inventories produced in preparation for product launches.

8. Goodwill and Other Intangibles

The following table summarizes goodwill activity by segment:

	Pharmaceutical	All Other	Total
Goodwill balance January 1, 2011	$10,345	$2,033	$12,378
Additions	144	—	144
Other[(1)]	(382)	15	(367)
Goodwill balance December 31, 2011	10,107	2,048	12,155
Other[(1)]	**(21)**	**—**	**(21)**
Goodwill balance December 31, 2012	**$10,086**	**$2,048**	**$12,134**

[(1)] *Other includes cumulative translation adjustments on goodwill balances and certain other adjustments. In addition, the amounts in 2011 reflect the reclassification of goodwill from the Pharmaceutical segment to the Consumer Care segment as a result of a segment change.*

Other intangibles at December 31 consisted of:

	2012			2011		
	Gross Carrying Amount	**Accumulated Amortization**	**Net**	Gross Carrying Amount	Accumulated Amortization	Net
Products and product rights	**$41,932**	**$16,678**	**$25,254**	$41,937	$11,872	$30,065
In-process research and development	**2,393**	**—**	**2,393**	2,671	—	2,671
Tradenames	**1,521**	**236**	**1,285**	1,523	170	1,353
Other	**896**	**745**	**151**	895	682	213
	$46,742	**$17,659**	**$29,083**	$47,026	$12,724	$34,302

Acquired intangibles include products and product rights, tradenames and patents, which are recorded at fair value, assigned an estimated useful life, and are amortized primarily on a straight-line basis over their estimated useful lives. Some of the Company's more significant acquired intangibles related to marketed products at December 31, 2012 include *Zetia*, $5.9 billion; *Vytorin*, $3.2 billion; *Nasonex*, $1.9 billion, *Claritin*, $1.6 billion and *NuvaRing*, $1.0 billion. During 2011, the Company recorded an impairment charge of $118 million related to a marketed product.

IPR&D represents the fair value assigned to incomplete research projects that the Company acquires through business combinations which, at the time of acquisition, have not reached technological feasibility. Amounts capitalized as IPR&D are accounted for as indefinite-lived intangible assets, subject to impairment testing until completion or abandonment of the projects. Upon successful completion of each project, the Company will make a separate determination as to the then useful life of the assets and begin amortization. During 2012 and 2011, $78 million and $666 million, respectively, of IPR&D was reclassified to products and product rights upon receipt of marketing approval in a major market. Some of the more significant projects in late-stage development include sugammadex sodium injection and an ezetimibe/atorvastatin combination product, both of which are currently under review by the FDA, and vorapaxar, which remains in Phase III clinical development.

During 2012, the Company recorded $200 million of IPR&D impairment charges within *Research and development* expenses primarily for pipeline programs that had previously been deprioritized and were subsequently deemed to have no alternative use during the period. During 2011, the Company recorded $587 million of IPR&D impairment charges primarily for pipeline programs that were abandoned and determined to have no alternative use, as well as for expected delays in the launch timing or changes in the cash flow assumptions for certain compounds. In addition, the impairment charges related to pipeline programs that had previously been deprioritized and were either deemed to have no alternative use during the period or were out-licensed to a third party for consideration that was less than the related asset's carrying value.

During 2010, the Company recorded $2.4 billion of IPR&D impairment charges within *Research and development* expenses. Of this amount, $1.7 billion related to the write-down of the vorapaxar intangible asset. The Company determined that developments in the clinical research program for vorapaxar, including the termination of a clinical trial, constituted a triggering event that required the Company to evaluate the vorapaxar intangible asset for impairment. The Company continues to monitor the remaining $350 million asset value for vorapaxar for further impairment. The remaining $763 million of IPR&D impairment charges recorded in 2010 were attributable to compounds that were abandoned and determined to have either no alternative use or were returned to the respective licensor, as well as from expected delays in the launch timing or changes in the cash flow assumptions for certain compounds.

All of the IPR&D projects that remain in development are subject to the inherent risks and uncertainties in drug development and it is possible that the Company will not be able to successfully develop and complete the IPR&D programs and profitably commercialize the underlying product candidates.

Aggregate amortization expense primarily recorded within *Materials and production* costs was $5.0 billion in 2012, $5.1 billion in 2011 and $4.7 billion in 2010. The estimated aggregate amortization expense for each of the next five years is as follows: 2013, $4.7 billion; 2014, $4.4 billion; 2015, $4.1 billion; 2016, $3.5 billion; 2017, $3.2 billion.

9. Joint Ventures and Other Equity Method Affiliates

Equity income from affiliates reflects the performance of the Company's joint ventures and other equity method affiliates and was comprised of the following:

Years Ended December 31	**2012**	2011	2010
AstraZeneca LP	**$621**	$574	$546
Other[(1)]	**21**	36	41
	$642	$610	$587

[(1)] *Primarily reflects results from Sanofi Pasteur MSD and Johnson & Johnson°Merck Consumer Pharmaceuticals Company (which was disposed of on September 29, 2011).*

AstraZeneca LP

In 1982, Merck entered into an agreement with Astra AB (“Astra”) to develop and market Astra products under a royalty-bearing license. In 1993, Merck’s total sales of Astra products reached a level that triggered the first step in the establishment of a joint venture business carried on by Astra Merck Inc. (“AMI”), in which Merck and Astra each owned a 50% share. This joint venture, formed in 1994, developed and marketed most of Astra’s new prescription medicines in the United States including Prilosec, the first of a class of medications known as proton pump inhibitors, which slows the production of acid from the cells of the stomach lining.

In 1998, Merck and Astra completed the restructuring of the ownership and operations of the joint venture whereby Merck acquired Astra’s interest in AMI, renamed KBI Inc. (“KBI”), and contributed KBI’s operating assets to a new U.S. limited partnership, Astra Pharmaceuticals L.P. (the “Partnership”), in exchange for a 1% limited partner interest. Astra contributed the net assets of its wholly owned subsidiary, Astra USA, Inc., to the Partnership in exchange for a 99% general partner interest. The Partnership, renamed AstraZeneca LP (“AZLP”) upon Astra’s 1999 merger with Zeneca Group Plc, became the exclusive distributor of the products for which KBI retained rights.

While maintaining a 1% limited partner interest in AZLP, Merck has consent and protective rights intended to preserve its business and economic interests, including restrictions on the power of the general partner to make certain distributions or dispositions. Furthermore, in limited events of default, additional rights will be granted to the Company, including powers to direct the actions of, or remove and replace, the Partnership’s chief executive officer and chief financial officer. Merck earns ongoing revenue based on sales of KBI products and such revenue was $915 million, $1.2 billion and $1.3 billion in 2012, 2011 and 2010, respectively, primarily relating to sales of Nexium, as well as Prilosec. In addition, Merck earns certain Partnership returns, which are recorded in *Equity income from affiliates*, as reflected in the table above. Such returns include a priority return provided for in the Partnership Agreement, a preferential return representing Merck’s share of undistributed AZLP GAAP earnings, and a variable return related to the Company’s 1% limited partner interest.

In conjunction with the 1998 restructuring discussed above, Astra purchased an option (the “Asset Option”) for a payment of $443 million, which was recorded as deferred income, to buy Merck’s interest in the KBI products, excluding the gastrointestinal medicines Nexium and Prilosec (the “Non-PPI Products”). In April 2010, AstraZeneca exercised the Asset Option. Merck received $647 million from AstraZeneca representing the net present value as of March 31, 2008 of projected future pretax revenue to be received by Merck from the Non-PPI Products, which was recorded as a reduction to the Company’s investment in AZLP. The Company recognized the $443 million of deferred income in 2010 as a component of *Other (income) expense, net*.

In addition, in 1998, Merck granted Astra an option to buy Merck’s common stock interest in KBI and, through it, Merck’s interest in Nexium and Prilosec as well as AZLP, exercisable in 2012. In June 2012, Merck and AstraZeneca amended the 1998 option agreement. The updated agreement eliminated AstraZeneca’s option to acquire Merck’s interest in KBI in 2012 and provides AstraZeneca a new option to acquire Merck’s interest in KBI in June 2014. As a result of the amended agreement, Merck continues to record supply sales and equity income from the partnership. In 2014, AstraZeneca has the option to purchase Merck’s interest in KBI based in part on the value of Merck’s interest in Nexium and Prilosec. AstraZeneca’s option is exercisable between March 1, 2014 and April 30, 2014. If AstraZeneca chooses to exercise this option, the closing date is expected to be June 30, 2014. Under the amended agreement, AstraZeneca will make a payment to Merck upon closing of $327 million, reflecting an estimate of the fair value of Merck’s interest in Nexium and Prilosec. This portion of the exercise price is subject to a true-up in 2018 based on actual sales from closing in 2014 to June 2018. The exercise price will also include an additional amount equal to a multiple of ten times Merck’s average 1% annual profit allocation in the partnership for the three years prior to exercise. The Company believes that it is likely that AstraZeneca will exercise its option in 2014.

Summarized financial information for AZLP is as follows:

Years Ended December 31	**2012**	2011	2010
Sales	**$4,694**	$4,659	$4,991
Materials and production costs	**2,177**	2,023	2,568
Other expense, net	**1,312**	1,392	886
Income before taxes[(1)]	**1,205**	1,244	1,537

December 31	**2012**	2011
Current assets	**$3,662**	$4,251
Noncurrent assets	**206**	250
Current liabilities	**3,145**	3,915

[(1)] *Merck's partnership returns from AZLP are generally contractually determined as noted above and are not based on a percentage of income from AZLP, other than with respect to Merck's 1% limited partnership interest.*

Sanofi Pasteur MSD

In 1994, Merck and Pasteur Mérieux Connaught (now Sanofi Pasteur S.A.) established an equally-owned joint venture to market vaccines in Europe and to collaborate in the development of combination vaccines for distribution in Europe. Joint venture vaccine sales were $1.1 billion for 2012, $1.1 billion for 2011 and $1.2 billion for 2010.

Johnson & Johnson°Merck Consumer Pharmaceuticals Company

In September 2011, Merck sold its 50% interest in the Johnson & Johnson°Merck Consumer Pharmaceuticals Company ("JJMCP") joint venture to J&J. The venture between Merck and J&J was formed in 1989 to develop, manufacture, market and distribute certain over-the-counter consumer products in the United States and Canada. Merck received a one-time payment of $175 million and recognized a pretax gain of $136 million in 2011 reflected in *Other (income) expense, net*. The partnership assets also included a manufacturing facility. Sales of products marketed by the joint venture were $62 million for the period from January 1, 2011 until the September 29, 2011 divestiture date and $129 million for 2010.

Investments in affiliates accounted for using the equity method, including the above joint ventures, totaled $1.3 billion at December 31, 2012 and $886 million at December 31, 2011. These amounts are reported in *Other assets*. Amounts due from the above joint ventures included in *Deferred income taxes and other current assets* were $302 million at December 31, 2012 and $276 million at December 31, 2011.

Summarized information for those affiliates (excluding AZLP disclosed separately above) is as follows:

Years Ended December 31	**2012**	2011[(1)]	2010
Sales	**$1,295**	$1,331	$1,486
Materials and production costs	**573**	584	598
Other expense, net	**705**	642	776
Income before taxes	**17**	105	112

December 31	**2012**	2011
Current assets	**$971**	$614
Noncurrent assets	**112**	75
Current liabilities	**480**	478
Noncurrent liabilities	**97**	140

[(1)] *Includes information for the JJMCP joint venture until its divestiture on September 29, 2011.*

10. Loans Payable, Long-Term Debt and Other Commitments

Loans payable at December 31, 2012 included $1.8 billion of notes due in 2013, $1.7 billion of commercial paper, $454 million of short-term foreign borrowings and $328 million of long-dated notes that are subject to repayment at the option of the holder. Loans payable at December 31, 2011 included $1.1 billion of commercial paper, $403 million of short-term foreign borrowings and $469 million of long-dated notes that are subject to repayment at the option of the holders. The weighted-average interest rate of the commercial paper borrowings was 0.15% and 0.11% at December 31, 2012 and 2011, respectively.

Long-term debt at December 31 consisted of:

	2012	2011
5.375% euro-denominated notes due 2014	**$ 2,058**	$ 2,062
6.50% notes due 2033	**1,310**	1,314
5.00% notes due 2019	**1,294**	1,300
3.875% notes due 2021	**1,147**	1,147
6.55% notes due 2037	**1,146**	1,148
6.00% notes due 2017	**1,112**	1,134
4.00% notes due 2015	**1,049**	1,068
4.75% notes due 2015	**1,044**	1,064
2.40% notes due 2022	**1,000**	—
1.10% notes due 2018	**998**	—
2.25% notes due 2016	**874**	882
5.85% notes due 2039	**749**	749
6.40% debentures due 2028	**499**	499
5.75% notes due 2036	**498**	498
5.95% debentures due 2028	**498**	498
3.60% notes due 2042	**492**	—
6.30% debentures due 2026	**248**	248
5.30% notes due 2013	**—**	1,308
4.375% notes due 2013	**—**	508
Other	**238**	98
	$16,254	$15,525

Other (as presented in the table above) included $165 million and $28 million at December 31, 2012 and 2011, respectively, of borrowings at variable rates averaging 0.1% for 2012 and 0.2% for 2011. Other also included foreign borrowings of $70 million and $62 million at December 31, 2012 and 2011, respectively, at varying rates up to 8.5%.

With the exception of the 6.3% debentures due 2026, the notes listed in the table above are redeemable in whole or in part, at Merck's option at any time, at varying redemption prices.

In September 2012, the Company closed an underwritten public offering of $2.5 billion senior unsecured notes consisting of $1.0 billion aggregate principal amount of 1.1% notes due 2018, $1.0 billion aggregate principal amount of 2.4% notes due 2022 and $500 million aggregate principal amount of 3.6% notes due 2042. Interest on the notes is payable semi-annually. The notes of each series are redeemable in whole or in part at any time at the Company's option at varying redemption prices. Proceeds from the notes were used for general corporate purposes, including contributions to the Company's pension plans and the repayment of outstanding commercial paper and certain debt maturities.

In connection with the Merger, effective as of November 3, 2009, the Company executed a full and unconditional guarantee of the then existing debt of its subsidiary MSD and MSD executed a full and unconditional guarantee of the then existing debt of the Company (excluding commercial paper), including for payments of principal and interest. These guarantees do not extend to debt issued subsequent to the Merger.

Certain of the Company's borrowings require that Merck comply with financial covenants including a requirement that the Total Debt to Capitalization Ratio (as defined in the applicable agreements) not exceed 60%. At December 31, 2012, the Company was in compliance with these covenants.

The aggregate maturities of long-term debt for each of the next five years are as follows: 2013, $1.8 billion; 2014, $2.1 billion; 2015, $2.1 billion; 2016, $884 million; 2017, $1.1 billion.

In May 2012, the Company terminated its existing credit facilities and entered into a new $4.0 billion, five-year credit facility maturing in May 2017. The facility provides backup liquidity for the Company's commercial paper borrowing facility and is to be used for general corporate purposes. The Company has not drawn funding from this facility.

Rental expense under operating leases, net of sublease income, was $396 million in 2012, $411 million in 2011 and $431 million in 2010. The minimum aggregate rental commitments under noncancellable leases are as follows: 2013, $203 million; 2014, $172 million; 2015, $146 million; 2016, $97 million; 2017, $72 million and thereafter, $145 million. The Company has no significant capital leases.

11. Contingencies and Environmental Liabilities

The Company is involved in various claims and legal proceedings of a nature considered normal to its business, including product liability, intellectual property, and commercial litigation, as well as additional matters such as antitrust actions and environmental matters. Except for the *Vioxx* Litigation (as defined below) for which a separate assessment is provided in this Note, in the opinion of the Company, it is unlikely that the resolution of these matters will be material to the Company's financial position, results of operations or cash flows.

Given the preliminary nature of the litigation discussed below, including the *Vioxx* Litigation, and the complexities involved in these matters, the Company is unable to reasonably estimate a possible loss or range of possible loss for such matters until the Company knows, among other factors, (i) what claims, if any, will survive dispositive motion practice, (ii) the extent of the claims, including the size of any potential class, particularly when damages are not specified or are indeterminate, (iii) how the discovery process will affect the litigation, (iv) the settlement posture of the other parties to the litigation and (v) any other factors that may have a material effect on the litigation.

The Company records accruals for contingencies when it is probable that a liability has been incurred and the amount can be reasonably estimated. These accruals are adjusted periodically as assessments change or additional information becomes available. For product liability claims, a portion of the overall accrual is actuarially determined and considers such factors as past experience, number of claims reported and estimates of claims incurred but not yet reported. Individually significant contingent losses are accrued when probable and reasonably estimable. Legal defense costs expected to be incurred in connection with a loss contingency are accrued when probable and reasonably estimable.

The Company's decision to obtain insurance coverage is dependent on market conditions, including cost and availability, existing at the time such decisions are made. The Company has evaluated its risks and has determined that the cost of obtaining product liability insurance outweighs the likely benefits of the coverage that is available and, as such, has no insurance for certain product liabilities effective August 1, 2004.

Vioxx Litigation

Product Liability Lawsuits

As previously disclosed, Merck is a defendant in approximately 90 federal and state lawsuits (the "*Vioxx* Product Liability Lawsuits") alleging personal injury or economic loss as a result of the purchase or use of *Vioxx*. Most of the remaining cases are coordinated in a multidistrict litigation in the U.S. District Court for the Eastern District of Louisiana (the "*Vioxx* MDL") before Judge Eldon E. Fallon.

There are pending in various U.S. courts putative class actions purportedly brought on behalf of individual purchasers or users of *Vioxx* seeking reimbursement for alleged economic loss. In the *Vioxx* MDL proceeding, approximately 30 such class actions remain. In June 2010, Merck moved to strike the class claims or for judgment on the pleadings regarding the master complaint, which includes the above-referenced cases, and briefing on that motion was completed in September 2010. The *Vioxx* MDL court heard oral argument on Merck's motion in October 2010 and took it under advisement.

In 2008, a Missouri state court certified a class of Missouri plaintiffs seeking reimbursement for out-of-pocket costs relating to *Vioxx*. On October 15, 2012, the parties executed a settlement agreement to resolve the litigation. The Company established a reserve of $39 million in the third quarter of 2012 in connection with that settlement agreement, which is the minimum amount that the Company is required to pay under the agreement. The court preliminarily approved the agreement and the class notice and claims program is underway.

In Indiana, plaintiffs filed a motion to certify a class of Indiana *Vioxx* purchasers in a case pending before the Circuit Court of Marion County, Indiana. That case has been dormant for several years. In April 2010, a Kentucky state court denied Merck's motion for summary judgment and certified a class of Kentucky plaintiffs seeking reimbursement for out-of-pocket costs relating to *Vioxx*. The trial court subsequently entered an amended class certification order in January 2011. Merck appealed that order to the Kentucky Court of Appeals and, on February 10, 2012, the Kentucky Court of Appeals reversed the trial court's amended class certification order and denied certification. The plaintiff petitioned the Kentucky Supreme Court to review the Court of Appeals' order and, on November 16, 2012, the Kentucky Supreme Court granted review. Briefing before the Kentucky Supreme Court is underway.

Merck has also been named as a defendant in lawsuits brought by state Attorneys General in five states. All of these actions except for the Kentucky action are in the *Vioxx* MDL proceeding. These actions allege that Merck misrepresented the safety of *Vioxx*. These suits seek recovery for expenditures on *Vioxx* by government-funded health care programs, such as Medicaid, and/or penalties for alleged Consumer Fraud Act violations. The Kentucky action is currently scheduled to proceed to trial in Kentucky state court in October 2013. On January 10, 2013, Merck finalized a settlement in the action filed by the Pennsylvania Attorney General under which Merck agreed to pay Pennsylvania $8.25 million in exchange for the dismissal of its lawsuit.

Shareholder Lawsuits

As previously disclosed, in addition to the *Vioxx* Product Liability Lawsuits, various putative class actions and individual lawsuits under federal securities laws and state laws have been filed against Merck and various current and former officers and directors (the "*Vioxx* Securities Lawsuits"). The *Vioxx* Securities Lawsuits are coordinated in a multidistrict litigation in the U.S. District Court for the District of New Jersey before Judge Stanley R. Chesler, and have been consolidated for all purposes. In August 2011, Judge Chesler granted in part and denied in part Merck's motion to dismiss the Fifth Amended Class Action Complaint in the consolidated securities action. Among other things, the claims based on statements made on or after the voluntary withdrawal of *Vioxx* on September 30, 2004 have been dismissed. In October 2011, defendants answered the Fifth Amended Class Action Complaint. On April 10, 2012, plaintiffs filed a motion for class certification and, on January 30, 2013, Judge Chesler granted that motion. Discovery is currently proceeding in accordance with the court's scheduling order.

As previously disclosed, several individual securities lawsuits filed by foreign institutional investors also are consolidated with the *Vioxx* Securities Lawsuits. In October 2011, plaintiffs filed amended complaints in each of the pending individual securities lawsuits. Also in October 2011, a new individual securities lawsuit (the "KBC Lawsuit") was filed in the District of New Jersey by several foreign institutional investors; that case is also consolidated with the *Vioxx* Securities Lawsuits. On January 20, 2012, defendants filed motions to dismiss in one of the individual lawsuits (the "ABP Lawsuit"). Briefing on the motions to dismiss was completed on March 26, 2012. On August 1, 2012, Judge Chesler granted in part and denied in part the motions to dismiss the ABP Lawsuit. Among other things, certain alleged misstatements and omissions were dismissed as inactionable and all state law claims were dismissed in full. On September 15, 2012, defendants answered the complaints in all individual actions other than the KBC Lawsuit; on the same day, defendants moved to dismiss the complaint in the KBC Lawsuit on statute of limitations grounds. On December 20, 2012, Judge Chesler denied the motion to dismiss the KBC Lawsuit and, on January 4, 2013, defendants answered the complaint in the KBC Lawsuit. Discovery is currently proceeding in the individual securities lawsuits together with discovery in the class action.

Insurance

The Company has Directors and Officers insurance coverage applicable to the *Vioxx* Securities Lawsuits with remaining stated upper limits of approximately $170 million, which is currently being used to partially fund the Company's legal fees. As a result of the previously disclosed insurance arbitration, additional insurance coverage for these claims should also be available, if needed, under upper-level excess policies that provide coverage for a variety of risks. There are disputes with the insurers about the availability of some or all of the Company's insurance coverage for these claims and there are likely to be additional disputes. The amounts actually recovered under the policies discussed in this paragraph may be less than the stated upper limits.

International Lawsuits

As previously disclosed, in addition to the lawsuits discussed above, Merck has been named as a defendant in litigation relating to *Vioxx* in Australia, Brazil, Canada, Europe and Israel (collectively, the "*Vioxx* International Lawsuits"). As previously disclosed, the Company has entered into an agreement to resolve all claims related to *Vioxx* in Canada pursuant to which the Company will pay a minimum of approximately $21 million but not more than an aggregate maximum of approximately $36 million. The agreement is pending approval by courts in Canada's provinces.

Reserves

The Company believes that it has meritorious defenses to the remaining *Vioxx* Product Liability Lawsuits, *Vioxx* Securities Lawsuits and *Vioxx* International Lawsuits (collectively, the "*Vioxx* Lawsuits") and will vigorously defend against them. In view of the inherent difficulty of predicting the outcome of litigation, particularly where there are many claimants and the claimants seek indeterminate damages, the Company is unable to predict the outcome of these matters and, at this time, cannot reasonably estimate the possible loss or range of loss with respect to the remaining *Vioxx* Lawsuits. The Company has established a reserve with respect to the Canadian settlement and with respect to certain other *Vioxx* Product Liability Lawsuits, including the Missouri matter discussed above. The Company also has an immaterial remaining reserve relating to the previously disclosed *Vioxx* investigation for the non-participating states with which litigation is continuing. The Company has established no other liability reserves with respect to the *Vioxx* Litigation. Unfavorable outcomes in the *Vioxx* Litigation could have a material adverse effect on the Company's financial position, liquidity and results of operations.

Other Product Liability Litigation

Fosamax

As previously disclosed, Merck is a defendant in product liability lawsuits in the United States involving *Fosamax* (the "*Fosamax* Litigation"). As of December 31, 2012, approximately 4,560 cases, which include approximately 5,140 plaintiff groups, had been filed and were pending against Merck in either federal or state court, including one case which seeks class action certification, as well as damages and/or medical monitoring. In approximately 1,230 of these actions, plaintiffs allege, among other things, that they have suffered osteonecrosis of the jaw ("ONJ"), generally subsequent to invasive dental procedures, such as tooth extraction or dental implants and/or delayed healing, in association with the use of *Fosamax*. In addition, plaintiffs in approximately 3,330 of these actions generally allege that they sustained femur fractures and/or other bone injuries ("Femur Fractures") in association with the use of *Fosamax*.

Cases Alleging ONJ and/or Other Jaw Related Injuries

In August 2006, the Judicial Panel on Multidistrict Litigation (the "JPML") ordered that certain *Fosamax* product liability cases pending in federal courts nationwide should be transferred and consolidated into one multidistrict litigation (the "*Fosamax* ONJ MDL") for coordinated pre-trial proceedings. The *Fosamax* ONJ MDL has been transferred to Judge John Keenan in the U.S. District Court for the Southern District of New York. As a result of the JPML order, approximately 960 of the cases are before Judge Keenan. In the first *Fosamax* ONJ MDL trial, *Boles v. Merck*, the *Fosamax* ONJ MDL court declared a mistrial because the eight person jury could not reach a unanimous verdict. The *Boles* case was retried in June 2010 and resulted in a verdict in favor of the plaintiff in the amount of $8 million. Merck filed post-trial motions seeking judgment as a matter of law or, in the alternative, a new trial. In October 2010, the court denied Merck's post-trial motions but *sua sponte* ordered a remittitur reducing the verdict to $1.5 million. Plaintiff rejected the remittitur ordered by the court and requested a new trial on damages. Plaintiff and Merck subsequently entered into a confidential stipulation as to the amount of plaintiff's damages that enabled Merck to appeal the underlying judgment, and Merck filed its appeal in the *Boles* case on October 18, 2012. Prior to 2013, three other cases were tried to verdict in the *Fosamax* ONJ MDL. Defense verdicts in favor of Merck were returned in each of those three cases. Plaintiffs have filed an appeal in two of the cases – *Graves v. Merck* and *Secrest v. Merck.* On January 30, 2013, the U.S. Court of Appeals for the Second Circuit affirmed the judgment in Merck's favor in *Secrest.*

In February 2011, Judge Keenan ordered that there will be two further bellwether trials conducted in the *Fosamax* ONJ MDL. *Spano v. Merck* and *Jellema v. Merck* were selected by the court to be tried in 2012, but each case was dismissed by the plaintiffs. On March 28, 2012, the court selected *Scheinberg v. Merck* as the next case to be tried. Trial in the *Scheinberg* case began on January 14, 2013 and, on February 5, 2013, the jury returned a mixed verdict finding in favor of Merck on plaintiff's design defect claim and finding in favor of plaintiff on her failure to warn claim awarding her $285 thousand in compensatory damages.

Outside the *Fosamax* ONJ MDL, in Florida, *Carballo v. Merck* was set for trial on October 15, 2012, but plaintiff dismissed the case and refiled it in the *Fosamax* ONJ MDL. *Anderson v. Merck* had been set for trial on January 14, 2013, but plaintiff dismissed the case prior to trial.

In addition, in July 2008, an application was made by the Atlantic County Superior Court of New Jersey requesting that all of the *Fosamax* cases pending in New Jersey be considered for mass tort designation and centralized management before one judge in New Jersey. In October 2008, the New Jersey Supreme Court ordered that all pending and future actions filed in New Jersey arising out of the use of *Fosamax* and seeking damages for existing dental and jaw-related injuries, including ONJ, but not solely seeking medical monitoring, be designated as a mass tort for centralized management purposes before Judge Carol E. Higbee in Atlantic County Superior Court. As of December 31, 2012, approximately 260 ONJ cases were pending against Merck in Atlantic County, New Jersey. In July 2009, Judge Higbee entered a Case Management Order (and various amendments thereto) setting forth a schedule that contemplates completing fact and expert discovery in an initial group of cases to be reviewed for trial. In February 2011, the jury in *Rosenberg v. Merck*, the first trial in the New Jersey coordinated proceeding, returned a verdict in Merck's favor. In April 2012, the jury in *Sessner v. Merck*, the second case tried in New Jersey, also returned a verdict in Merck's favor. Plaintiffs have filed an appeal in both cases.

In California, the parties are reviewing the claims of two plaintiffs in the *Carrie Smith, et al. v. Merck* case and the claims in *Pedrojetti v. Merck*. The cases of one or more of these plaintiffs may be tried in 2013.

Discovery is ongoing in the *Fosamax* ONJ MDL litigation, the New Jersey coordinated proceeding, and the remaining jurisdictions where *Fosamax* ONJ cases are pending. The Company intends to defend against these lawsuits.

Cases Alleging Femur Fractures

In March 2011, Merck submitted a Motion to Transfer to the JPML seeking to have all federal cases alleging Femur Fractures consolidated into one multidistrict litigation for coordinated pre-trial proceedings. The Motion to Transfer was granted in May 2011, and all federal cases involving allegations of Femur Fracture have been or will be transferred to a multidistrict litigation in the District of New Jersey (the "*Fosamax* Femur Fracture MDL"). As a result of the JPML order, approximately 820 cases were pending in the *Fosamax* Femur Fracture MDL as of December 31, 2012. A Case Management Order has been entered that requires the parties to review 40 cases (later reduced to 33 cases). Judge Joel Pisano has selected four cases from that group to be tried as the initial bellwether cases in the *Fosamax* Femur Fracture MDL and has set an April 8, 2013 trial date for the first bellwether case, which will be *Glynn v. Merck*. The *Zessin v. Merck* case is set to be tried in September 2013; the *Young v. Merck* case is set to be tried in January 2014; and the *Johnson v. Merck* case is set to be tried in May 2014.

As of December 31, 2012, approximately 2,075 cases alleging Femur Fractures have been filed in New Jersey state court and are pending before Judge Higbee in Atlantic County Superior Court. The parties have selected an initial group of 30 cases to be reviewed through fact discovery. Judge Higbee has set March 11, 2013 as the date for the first trial of the New Jersey state Femur Fracture cases, which will be *Su v. Merck*.

As of December 31, 2012, approximately 420 cases alleging Femur Fractures have been filed in California state court. A petition was filed seeking to coordinate all Femur Fracture cases filed in California state court before a single judge in Orange County, California. The petition was granted and Judge Steven Perk is now presiding over the coordinated proceedings. No scheduling order has yet been entered.

Additionally, there are eight Femur Fracture cases pending in other state courts. A trial date has been set for August 12, 2013 for the *Barnes v. Merck* case pending in Alabama state court.

Discovery is ongoing in the *Fosamax* Femur Fracture MDL and in state courts where Femur Fracture cases are pending and the Company intends to defend against these lawsuits.

NuvaRing

As previously disclosed, beginning in May 2007, a number of complaints were filed in various jurisdictions asserting claims against the Company's subsidiaries Organon USA, Inc., Organon Pharmaceuticals USA, Inc., Organon International (collectively, "Organon"), and the Company arising from Organon's marketing and sale of *NuvaRing*, a combined hormonal contraceptive vaginal ring. The plaintiffs contend that Organon and Schering-Plough, among other things, failed to adequately design and manufacture *NuvaRing* and failed to adequately warn of the alleged increased risk of venous thromboembolism ("VTE") posed by *NuvaRing*, and/or downplayed the risk of VTE. The plaintiffs seek damages for injuries allegedly sustained from their product use, including some alleged deaths, heart attacks and strokes. The majority of the cases are currently pending in a federal multidistrict litigation (the "*NuvaRing* MDL") venued in Missouri and in a coordinated proceeding in New Jersey state court.

As of December 31, 2012, there were approximately 1,315 *NuvaRing* cases. Of these cases, approximately 1,105 are or will be pending in the *NuvaRing* MDL in the U.S. District Court for the Eastern District of Missouri before Judge Rodney Sippel, and approximately 200 are pending in coordinated discovery proceedings in the Bergen County Superior Court of New Jersey before Judge Brian R. Martinotti. Five additional cases are pending in various other state courts.

Pursuant to orders of Judge Sippel in the *NuvaRing* MDL, the parties originally selected a pool of more than 20 cases to prepare for trial and that pool has since been narrowed to eight cases from which the first trials in the *NuvaRing* MDL will be selected. The first *NuvaRing* MDL trial is expected to take place in the summer of 2013. Pursuant to Judge Martinotti's order in the New Jersey proceeding, the parties selected nine trial pool cases to be prepared for trial and the first trial is expected to commence in May 2013. The parties have completed fact discovery in the originally selected trial pool cases in each jurisdiction and expert discovery has been completed in those first trial pool cases. Certain replacement trial pool cases remain in fact discovery.

The Company has filed motions related to the admissibility of expert testimony and motions for summary judgment. The Company expects substantive hearings on the motions for summary judgment to take place in the New Jersey cases in early 2013, followed by substantive hearings on the admissibility of expert testimony after the resolution of the summary judgment motions. The Company expects substantive hearings on the motions for summary judgment in the *NuvaRing* MDL cases to take place in spring 2013, followed by hearings on the admissibility of expert testimony. The Company has certain insurance coverage available to it, which is currently being used to partially fund the Company's legal fees. The Company intends to defend against these lawsuits.

Propecia/Proscar

As previously disclosed, Merck is a defendant in product liability lawsuits in the United States involving *Propecia* and/or *Proscar*. As of December 31, 2012, approximately 385 lawsuits involving a total of approximately 550 plaintiffs (in a few instances spouses are joined in the suits) who allege that they have experienced persistent sexual side effects following cessation of treatment with *Propecia* and/or *Proscar* have been filed against Merck. The lawsuits, which are in their early stages, have been filed in various federal courts and in state court in New Jersey. The federal lawsuits have been consolidated for pretrial purposes in a federal MDL before Judge John Gleeson of the Eastern District of New York. The matters pending in state court in New Jersey have been consolidated before Judge Jessica Mayer in Middlesex County. The Company intends to defend against these lawsuits.

***Vytorin/Zetia* Litigation**

As previously disclosed, in April 2008, a Merck shareholder filed a putative class action lawsuit in federal court which has been consolidated in the District of New Jersey with another federal securities lawsuit under the caption *In re Merck & Co., Inc. Vytorin Securities Litigation*. An amended consolidated complaint was filed in October 2008 and named as defendants Merck; Merck/Schering-Plough Pharmaceuticals, LLC; and certain of the Company's current and former officers and directors. The complaint alleges that Merck delayed releasing unfavorable results of the ENHANCE clinical trial regarding the efficacy of *Vytorin* and that Merck made false and misleading statements about expected earnings, knowing that once the results of the ENHANCE study were released, sales of *Vytorin* would decline and Merck's earnings would suffer. In December 2008, Merck and the other defendants moved to dismiss this lawsuit on the grounds that the plaintiffs failed to state a claim for which relief can be granted. In September 2009, the court denied defendants' motion to dismiss. On March 1, 2012, defendants filed a motion for summary judgment. On September 25, 2012, the court granted lead plaintiffs' amended motion for class certification and denied defendants' motion for summary judgment. On February 13, 2013, Merck announced that it had reached an agreement in principle with plaintiffs to settle this matter for $215 million. The settlement is subject to court approval. The proposed settlement has been reflected in the Company's 2012 financial results as discussed below.

There is a similar consolidated, putative class action securities lawsuit pending in the District of New Jersey, filed by a Schering-Plough shareholder against Schering-Plough and its former Chairman, President and Chief Executive Officer, Fred Hassan, under the caption *In re Schering-Plough Corporation/ENHANCE Securities Litigation*. The amended consolidated complaint was filed in September 2008 and names as defendants Schering-Plough; Merck/Schering-Plough Pharmaceuticals, LLC; certain of the Company's current and former officers and directors; and underwriters who participated in an August 2007 public offering of Schering-Plough's common and preferred stock. In December 2008, Schering-Plough and the other defendants filed motions to dismiss this lawsuit on the grounds that the plaintiffs failed to state a claim for which relief can be granted. In September 2009, the court denied defendants' motions to dismiss. On March 1, 2012, the Schering-Plough defendants filed a motion for partial summary judgment and the underwriter defendants filed a motion for summary judgment. On September 25, 2012, the court granted lead plaintiffs' amended motion for class certification and denied defendants' motions for summary judgment. On February 13, 2013, Merck announced that it had reached an agreement in principle with plaintiffs to settle this matter for $473 million. The settlement is subject to court approval. If approved, this settlement will exhaust the remaining Directors and Officers insurance coverage applicable to the *Vytorin* lawsuits brought by the legacy Schering-Plough shareholders. The proposed settlement has been reflected in the Company's 2012 financial results and, together with the settlement described in the preceding paragraph, resulted in an aggregate charge of $493 million after taking into account anticipated insurance recoveries of $195 million.

Governmental Proceedings

As previously disclosed, Merck has received a Civil Investigative Demand ("CID") issued by the Department of Justice (the "DOJ") addressed to Inspire, a company acquired by Merck in May 2011. The CID advises that it relates to a False Claims Act investigation concerning allegations that Inspire caused the submission of false claims to federal health benefits programs for the drug AzaSite by marketing it for the treatment of indications not approved by the FDA. The Company is cooperating with the DOJ in its investigation.

As previously disclosed, the Company received a subpoena from the U.S. Attorney's Office for the Eastern District of California in 2010 requesting information in a civil federal health care investigation relating to the Company's marketing and selling activities with respect to Integrilin and *Avelox* from January 2003 to June 2010. In December 2012, the U.S. District Court for the Eastern District of California unsealed a complaint that a former employee of the Company had filed against it in 2009 under the federal False Claims Act and the False Claims Acts of various states. The complaint alleges that the Company caused false claims to be made to federal and state health care programs by promoting Integrilin for unapproved indications and providing unlawful payments and benefits to physicians and others to increase the utilization of Integrilin and *Avelox*. The federal government and the states under whose statutes the suit was filed each had the right, after investigating these allegations, to intervene in this suit and assume responsibility for its direction, but each of them has notified the court that they decline to intervene. The Company intends to defend against the suit.

The Company has also previously disclosed that it has received a subpoena requesting information related to the Company's marketing and selling activities with respect to *Temodar*, *PegIntron* and *Intron A*, from January 1, 2004 to the present, in a federal health care investigation under criminal statutes. The Company has been informed by the U.S. Attorney's Office for the District of Massachusetts that this subpoena will not be enforced and that no further action on the Company's part is required.

As previously disclosed, the Company has received letters from the DOJ and the SEC that seek information about activities in a number of countries and reference the Foreign Corrupt Practices Act. The Company is cooperating with the agencies in their requests and believes that this inquiry is part of a broader review of pharmaceutical industry practices in foreign countries. In that regard, the Company has received and may continue to receive additional requests for information from either or both of the DOJ and the SEC.

As previously disclosed, on June 21, 2012, the U.S. District Court for the Eastern District of Pennsylvania unsealed a complaint that has been filed against the Company under the federal False Claims Act by two former employees alleging, among other things, that the Company defrauded the U.S. government by falsifying data in connection with a clinical study conducted on the mumps component of the Company's *M-M-R* II vaccine. The complaint alleges the fraud took place between 1999 and 2001. The U.S. government had the right to participate in and take over the prosecution of this lawsuit, but has notified the court that it declined to exercise that right. The two former employees are pursuing the lawsuit without the involvement of the U.S. government. In addition, a putative class action lawsuit has been filed against the Company in the Eastern District of Pennsylvania on behalf of direct purchasers of the *M-M-R* II vaccine which is predicated on the allegations in the False Claims Act complaint and charges that the Company misrepresented the efficacy of the *M-M-R* II vaccine in violation of federal antitrust laws and various state consumer protection laws. The Company intends to defend against these lawsuits.

Commercial Litigation

AWP Litigation

As previously disclosed, the Company and/or certain of its subsidiaries remain defendants in cases brought by various states alleging manipulation by pharmaceutical manufacturers of Average Wholesale Prices ("AWP"), which are sometimes used by public and private payors in calculating provider reimbursement levels. The outcome of these lawsuits could include substantial damages, the imposition of substantial fines and penalties and injunctive or administrative remedies.

Since the start of 2012, the Company has settled certain AWP cases brought by the states of Alabama, Alaska, Kansas, Kentucky, Louisiana, Oklahoma, and Mississippi. The Company and/or certain of its subsidiaries continue to be defendants in cases brought by six states.

The Company has also been reinstated as a defendant in a putative class action in New Jersey Superior Court which alleges on behalf of third-party payers and individuals that manufacturers inflated drug prices by manipulation of AWPs and other means. This case was originally dismissed against the Company without prejudice in 2007. The Company intends to defend against this lawsuit.

K-DUR Antitrust Litigation

As previously disclosed, in June 1997 and January 1998, Schering-Plough settled patent litigation with Upsher-Smith, Inc. ("Upsher-Smith") and ESI Lederle, Inc. ("Lederle"), respectively, relating to generic versions of K-DUR, Schering-Plough's long-acting potassium chloride product supplement used by cardiac patients, for which Lederle and Upsher-Smith had filed Abbreviated New Drug Applications ("ANDAs"). Following the commencement of an administrative proceeding by the U.S. Federal Trade Commission (the "FTC") in 2001 alleging anti-competitive effects from those settlements (which has been resolved in Schering-Plough's favor), putative class and non-class action suits were filed on behalf of direct and indirect purchasers of K-DUR against Schering-Plough, Upsher-Smith and Lederle and were consolidated in a multi-district litigation in the U.S. District Court for the District of New Jersey. These suits claimed violations of federal and state antitrust laws, as well as other state statutory and common law causes of action, and sought unspecified damages. In April 2008, the indirect purchasers voluntarily dismissed their case. In March 2010, the District Court granted summary judgment to the defendants on the remaining lawsuits and dismissed the matter in its entirety. However, in July 2012, the 3rd Circuit

Court of Appeals reversed the District Court's judgment and remanded the case for further proceedings. At the same time, the 3rd Circuit upheld a December 2008 decision by the District Court to certify certain direct purchaser plaintiffs' claims as a class action.

In August 2012, the Company filed a petition for certiorari with the U.S. Supreme Court seeking review of the Third Circuit's reversal of summary judgment. The Supreme Court has taken no action on that petition, but in December 2012 it granted certiorari in an unrelated case in which the 11th Circuit Court of Appeals reached a decision that appears in conflict with the 3rd Circuit's holding in the Company's case. The Company expects that the issue it sought to raise with the Supreme Court will be resolved by the Supreme Court's pending decision in this 11th Circuit case.

Nexium Antitrust Litigation

As previously disclosed, in September 2012, the Company and certain of its subsidiaries were among the defendants named in a putative class action lawsuit brought on behalf of direct purchasers of Nexium in federal court in New Jersey. The lawsuit alleges violations of federal antitrust law arising from settlements reached by and among the defendants to resolve certain patent litigation relating to the entry of generic esomeprazole on the U.S. market. Specifically, the plaintiffs contend that these settlements had the effect of impermissibly delaying the entry of generic esomeprazole in the United States and extending the monopoly power of Nexium, leading to higher average market prices. On January 8, 2013, the Company and its subsidiaries were dismissed without prejudice from the lawsuit.

Coupon Litigation

As previously disclosed, since March 2012, a number of private health plans have filed separate putative class action lawsuits against the Company alleging that Merck's coupon programs injured health insurers by reducing beneficiary co-payment amounts, thereby allegedly causing beneficiaries to purchase higher-priced drugs than they otherwise would have purchased and increasing the insurers' reimbursement costs. The actions, which are pending in the U.S. District Court for the District of New Jersey, seek damages and injunctive relief barring the Company from issuing coupons that would reduce beneficiary co-pays on behalf of putative nationwide classes of health insurers. Similar actions relating to manufacturer coupon programs have been filed against several other pharmaceutical manufacturers in a variety of federal courts. The Company intends to defend against these lawsuits.

Patent Litigation

From time to time, generic manufacturers of pharmaceutical products file ANDAs with the FDA seeking to market generic forms of the Company's products prior to the expiration of relevant patents owned by the Company. To protect its patent rights, the Company may file patent infringement lawsuits against such generic companies. Certain products of the Company (or marketed via agreements with other companies) currently involved in such patent infringement litigation in the United States include: AzaSite, *Emend* for Injection, Integrilin, *Nasonex*, Nexium, *Vytorin* and *Zetia*. Similar lawsuits defending the Company's patent rights may exist in other countries. The Company intends to vigorously defend its patents, which it believes are valid, against infringement by generic companies attempting to market products prior to the expiration of such patents. As with any litigation, there can be no assurance of the outcomes, which, if adverse, could result in significantly shortened periods of exclusivity for these products and, with respect to products acquired through mergers and acquisitions, potentially significant intangible asset impairment charges.

AzaSite — In May 2011, a patent infringement lawsuit was filed in the United States against Sandoz Inc. ("Sandoz") in respect of Sandoz's application to the FDA seeking pre-patent expiry approval to market a generic version of AzaSite. The lawsuit automatically stays FDA approval of Sandoz's ANDA until October 2013 or until an adverse court decision, if any, whichever may occur earlier.

Emend for Injection — In May 2012, a patent infringement lawsuit was filed in the United States against Sandoz in respect of Sandoz's application to the FDA seeking pre-patent expiry approval to market a generic version of *Emend* for Injection. The lawsuit automatically stays FDA approval of Sandoz's ANDA until July 2015 or until an adverse court decision, if any, whichever may occur earlier. In June 2012, a patent infringement lawsuit was filed in the United States against Accord Healthcare, Inc. US, Accord Healthcare, Inc. and Intas

Pharmaceuticals Ltd (collectively, “Intas”) in respect of Intas’ application to the FDA seeking pre-patent expiry approval to market a generic version of *Emend* for Injection. The lawsuit automatically stays FDA approval of Intas’ ANDA until July 2015 or until an adverse court decision, if any, whichever may occur earlier.

Integrilin — In February 2009, a patent infringement lawsuit was filed (jointly with Millennium Pharmaceuticals, Inc.) in the United States against Teva Parenteral Medicines, Inc. (“TPM”) in respect of TPM’s application to the FDA seeking approval to sell a generic version of Integrilin prior to the expiry of the last to expire listed patent. In October 2011, the parties entered a settlement agreement allowing TPM to sell a generic version of Integrilin beginning June 2, 2015. In November 2012, a patent infringement lawsuit was filed against APP Pharmaceuticals, Inc. and Fresenius Kabi USA Inc. (collectively “APP”) in respect of APP’s application to the FDA seeking approval to sell a generic version of Integrilin prior to the expiry of the last to expire listed patent. The lawsuit automatically stays FDA approval of APP’s ANDA until April 2015 or until an adverse court decision, if any, whichever may occur earlier.

Nasonex — In December 2009, a patent infringement lawsuit was filed in the United States against Apotex Corp. (“Apotex”) in respect of Apotex’s application to the FDA seeking pre-patent expiry approval to market a generic version of *Nasonex*. A trial in this matter was held in April 2012. A decision was issued on June 15, 2012, holding that the Merck patent covering mometasone furoate monohydrate was valid, but that it was not infringed by Apotex’s proposed product. The finding of non-infringement is under appeal.

Nexium — Patent infringement lawsuits were brought (jointly with AstraZeneca) in the United States against the following generic companies: Ranbaxy Laboratories Ltd., IVAX Pharmaceuticals, Inc. (later acquired by Teva Pharmaceuticals, Inc. (“Teva”)), Dr. Reddy’s Laboratories, Sandoz, Lupin Ltd., Hetero Drugs Limited Unit III and Torrent Pharmaceuticals Ltd. in response to each generic company’s application seeking pre-patent expiry approval to sell a generic version of Nexium. Settlements have been reached in each of these lawsuits, the terms of which provide that the respective generic company may bring a generic version of esomeprazole product to market on May 27, 2014. In addition, a patent infringement lawsuit was also filed (jointly with AstraZeneca) in February 2010 in the United States against Sun Pharma Global Fze (“Sun Pharma”) in respect of its application to the FDA seeking pre-patent expiry approval to sell a generic version of Nexium IV, which lawsuit was settled with an agreement which provides that Sun Pharma will be entitled to bring its generic esomeprazole IV product to market in the United States on January 1, 2014. Finally, additional patent infringement lawsuits have been filed (jointly with AstraZeneca) in the United States against Hamni USA, Inc. (“Hamni”) and Mylan Laboratories Limited (“Mylan Labs”) related to their applications to the FDA seeking pre-patent expiry approval to sell generic versions of Nexium. The Hamni and Mylan Labs applications to the FDA remain stayed until May 2013 and August 2014, respectively, or until earlier adverse court decisions, if any, whichever may occur earlier.

Vytorin — In December 2009, a patent infringement lawsuit was filed in the United States against Mylan Pharmaceuticals, Inc. (“Mylan”) in respect of Mylan’s application to the FDA seeking pre-patent expiry approval to sell a generic version of *Vytorin*. A trial against Mylan jointly in respect of *Zetia* and *Vytorin* was conducted in December 2011. In April 2012, the court issued a decision finding the patent valid and enforceable. Accordingly, Mylan’s ANDA will not be approvable until April 25, 2017. On February 7, 2013, the Court of Appeals for the Federal Circuit affirmed the lower court decision. In February 2010, a patent infringement lawsuit was filed in the United States against Teva in respect of Teva’s application to the FDA seeking pre-patent expiry approval to sell a generic version of *Vytorin*. In July 2011, the patent infringement lawsuit was dismissed and Teva agreed not to sell generic versions of *Zetia* or *Vytorin* until the Company’s exclusivity rights expire on April 25, 2017, except in certain circumstances. In August 2010, a patent infringement lawsuit was filed in the United States against Impax Laboratories Inc. (“Impax”) in respect of Impax’s application to the FDA seeking pre-patent expiry approval to sell a generic version of *Vytorin*. An agreement was reached with Impax to stay the lawsuit pending the outcome of the lawsuit with Mylan. In October 2011, a patent infringement lawsuit was filed in the United States against Actavis Inc. (“Actavis”) in respect to Actavis’ application to the FDA seeking pre-patent expiry approval to sell a generic version of *Vytorin*. An agreement was reached with Actavis to stay the lawsuit pending the outcome of the lawsuit with Mylan.

Zetia — In March 2007, a patent infringement lawsuit was filed in the United States against Glenmark Pharmaceuticals Inc., USA and its parent corporation (collectively, “Glenmark”) in respect of Glenmark’s application to the FDA seeking pre-patent expiry approval to sell a generic version of *Zetia*. In May 2010, Glenmark agreed to a settlement by virtue of which Glenmark will be permitted to launch its generic product in the United States on December 12, 2016, subject to receiving final FDA approval. In June 2010, a patent infringement lawsuit was filed in the United States against Mylan in respect of Mylan's application to the FDA seeking pre-patent expiry approval to sell a generic version of *Zetia*. A trial against Mylan jointly in respect of *Zetia* and *Vytorin* was conducted in December 2011. In April 2012, the court issued a decision finding the patent valid and enforceable. Accordingly, Mylan's ANDA will not be approvable until April 25, 2017. On February 7, 2013, the Court of Appeals for the Federal Circuit affirmed the lower court decision. In September 2010, a patent infringement lawsuit was filed in the United States against Teva in respect of Teva's application to the FDA seeking pre-patent expiry approval to sell a generic version of *Zetia*. In July 2011, the patent infringement lawsuit was dismissed without any rights granted to Teva. In September 2012, a patent infringement suit was filed in the United States against Sandoz in respect of Sandoz's application to the FDA seeking pre-patent expiry approval to market a generic version of *Zetia*. The lawsuit automatically stays FDA approval of Sandoz's ANDA until February 2015 or until an adverse court decision, if any, whichever may occur earlier.

Environmental Litigation

As previously disclosed, approximately 2,200 plaintiffs filed an amended complaint against Merck and 12 other defendants in U.S. District Court, Eastern District of California asserting claims under the Clean Water Act, the Resource Conservation and Recovery Act, as well as negligence and nuisance. The suit seeks damages for personal injury, diminution of property value, medical monitoring and other alleged real and personal property damage associated with groundwater, surface water and soil contamination found at the site of a former Merck subsidiary in Merced, California. Certain of the other defendants in this suit have settled with plaintiffs regarding some or all aspects of plaintiffs' claims. This lawsuit is proceeding in a phased manner. A jury trial commenced in February 2011 during which a jury was asked to make certain factual findings regarding whether contamination moved off-site to any areas where plaintiffs could have been exposed to such contamination and, if so, when, where and in what amounts. Defendants in this "Phase 1" trial included Merck and three of the other original 12 defendants. In March 2011, the Phase 1 jury returned a mixed verdict, finding in favor of Merck and the other defendants as to some, but not all, of plaintiffs' claims. Specifically, the jury found that contamination from the site did not enter or affect plaintiffs' municipal water supply wells or any private domestic wells. The jury found, however, that plaintiffs could have been exposed to contamination via air emissions prior to 1994, as well as via surface water in the form of storm drainage channeled into an adjacent irrigation canal, including during a flood in April 2006. In response to post-trial motions by Merck and other defendants, on September 7, 2011, the court entered an order setting aside a part of the Phase 1 jury's findings that had been in favor of plaintiffs. Specifically, the court held that plaintiffs could not have been exposed to any contamination in surface or flood water during the April 2006 flood or, in fact, at any time later than 1991. Merck's motion for reconsideration of the remainder of the jury's Phase I verdict that was adverse to Merck was denied. Following the retirement of the judge handling this case, on September 21, 2011, the case was assigned to Judge David O. Carter of the U.S. District Court for the Central District of California. Judge Carter selected 10 plaintiffs whose claims would be reviewed and, depending on the outcome of Merck's summary judgment motions, possibly tried in early 2013. Plaintiffs subsequently withdrew the claim of one of those 10 plaintiffs, leaving nine whose claims may proceed to trial. The court has dismissed the claims of 1,083 of the plaintiffs in this action whose claims were precluded by aspects of the Phase I jury findings and the court's subsequent orders. Subject to the court's anticipated rulings on defendants' potentially dispositive summary judgment and other pre-trial motions, trial of the nine selected trial plaintiffs' claims is anticipated to begin near the end of March 2013.

Other Litigation

There are various other pending legal proceedings involving the Company, principally product liability and intellectual property lawsuits. While it is not feasible to predict the outcome of such proceedings, in the opinion of the Company, either the likelihood of loss is remote or any reasonably possible loss associated with the resolution of such proceedings is not expected to be material to the Company's financial position, results of operations or cash flows either individually or in the aggregate.

Legal Defense Reserves

Legal defense costs expected to be incurred in connection with a loss contingency are accrued when probable and reasonably estimable. Some of the significant factors considered in the review of these legal defense reserves are as follows: the actual costs incurred by the Company; the development of the Company's legal defense strategy and structure in light of the scope of its litigation; the number of cases being brought against the Company; the costs and outcomes of completed trials and the most current information regarding anticipated timing, progression, and related costs of pre-trial activities and trials in the associated litigation. The amount of legal defense reserves as of December 31, 2012 and December 31, 2011 of approximately $260 million and $240 million, respectively, represents the Company's best estimate of the minimum amount of defense costs to be incurred in connection with its outstanding litigation; however, events such as additional trials and other events that could arise in the course of its litigation could affect the ultimate amount of legal defense costs to be incurred by the Company. The Company will continue to monitor its legal defense costs and review the adequacy of the associated reserves and may determine to increase the reserves at any time in the future if, based upon the factors set forth, it believes it would be appropriate to do so.

Environmental Matters

The Company and its subsidiaries are parties to a number of proceedings brought under the Comprehensive Environmental Response, Compensation and Liability Act, commonly known as Superfund, and other federal and state equivalents. These proceedings seek to require the operators of hazardous waste disposal facilities, transporters of waste to the sites and generators of hazardous waste disposed of at the sites to clean up the sites or to reimburse the government for cleanup costs. The Company has been made a party to these proceedings as an alleged generator of waste disposed of at the sites. In each case, the government alleges that the defendants are jointly and severally liable for the cleanup costs. Although joint and several liability is alleged, these proceedings are frequently resolved so that the allocation of cleanup costs among the parties more nearly reflects the relative contributions of the parties to the site situation. The Company's potential liability varies greatly from site to site. For some sites the potential liability is *de minimis* and for others the final costs of cleanup have not yet been determined. While it is not feasible to predict the outcome of many of these proceedings brought by federal or state agencies or private litigants, in the opinion of the Company, such proceedings should not ultimately result in any liability which would have a material adverse effect on the financial position, results of operations, liquidity or capital resources of the Company. The Company has taken an active role in identifying and providing for these costs and such amounts do not include any reduction for anticipated recoveries of cleanup costs from former site owners or operators or other recalcitrant potentially responsible parties.

In management's opinion, the liabilities for all environmental matters that are probable and reasonably estimable have been accrued and totaled $145 million and $171 million at December 31, 2012 and 2011, respectively. These liabilities are undiscounted, do not consider potential recoveries from other parties and will be paid out over the periods of remediation for the applicable sites, which are expected to occur primarily over the next 15 years. Although it is not possible to predict with certainty the outcome of these matters, or the ultimate costs of remediation, management does not believe that any reasonably possible expenditures that may be incurred in excess of the liabilities accrued should exceed $112 million in the aggregate. Management also does not believe that these expenditures should result in a material adverse effect on the Company's financial position, results of operations, liquidity or capital resources for any year.

12. Equity

The Merck certificate of incorporation authorizes 6,500,000,000 shares of common stock and 20,000,000 shares of preferred stock. Of the authorized shares of preferred stock, there was a series of 11,500,000 shares which was designated as 6% mandatory convertible preferred stock.

Capital Stock

A summary of common stock and treasury stock transactions (shares in millions) is as follows:

	2012		2011		2010	
	Common Stock	**Treasury Stock**	Common Stock	Treasury Stock	Common Stock	Treasury Stock
Balance January 1	**3,577**	**536**	3,577	495	3,563	454
Purchases of treasury stock	**—**	**62**	—	58	—	47
Issuances*(1)*	**—**	**(48)**	—	(17)	10	(6)
Mandatory conversion of 6% convertible preferred stock*(2)*	**—**	**—**	—	—	4	—
Balance December 31	**3,577**	**550**	3,577	536	3,577	495

(1) *Issuances primarily reflect activity under share-based compensation plans.*

(2) *In 2010, the remaining outstanding 6% mandatory convertible preferred stock not converted in connection with the Merger automatically converted by its terms into the right to receive cash and shares of Merck common stock. As a result of the conversion, approximately $72 million was paid to the holders and approximately 4 million Merck common shares were issued.*

Noncontrolling Interests

In connection with the 1998 restructuring of AMI, Merck assumed $2.4 billion par value preferred stock with a dividend rate of 5% per annum, which is carried by KBI and included in *Noncontrolling interests*. If AstraZeneca exercises its option to acquire Merck's interest in AZLP (see Note 9) this preferred stock obligation will be retired.

13. Share-Based Compensation Plans

The Company has share-based compensation plans under which the Company grants restricted stock units ("RSUs") and performance share units ("PSUs") to certain management level employees. In addition, employees, non-employee directors and employees of certain of the Company's equity method investees may be granted options to purchase shares of Company common stock at the fair market value at the time of grant. These plans were approved by the Company's shareholders.

At December 31, 2012, 180 million shares collectively were authorized for future grants under the Company's share-based compensation plans. These awards are settled primarily with treasury shares.

Employee stock options are granted to purchase shares of Company stock at the fair market value at the time of grant. These awards generally vest one-third each year over a three-year period, with a contractual term of 7-10 years. RSUs are stock awards that are granted to employees and entitle the holder to shares of common stock as the awards vest. The fair value of the stock option and RSU awards is determined and fixed on the grant date based on the Company's stock price. PSUs are stock awards where the ultimate number of shares issued will be contingent on the Company's performance against a pre-set objective or set of objectives. The fair value of each PSU is determined on the date of grant based on the Company's stock price. For RSUs and certain PSUs granted before December 31, 2009 employees participate in dividends on the same basis as common shares and such dividends are nonforfeitable by the holder. For RSUs and PSUs issued on or after January 1, 2010, dividends declared during the vesting period are payable to the employees only upon vesting. Over the PSU performance period, the number of shares of stock that are expected to be issued will be adjusted based on the probability of achievement of a performance target and final compensation expense will be recognized based on the ultimate number of shares issued. RSU and PSU distributions will be in shares of Company stock after the end of the vesting or performance period, generally three years, subject to the terms applicable to such awards.

Total pretax share-based compensation cost recorded in 2012, 2011 and 2010 was $335 million, $369 million and $509 million, respectively, with related income tax benefits of $105 million, $118 million and $173 million, respectively.

The Company uses the Black-Scholes option pricing model for determining the fair value of option grants. In applying this model, the Company uses both historical data and current market data to estimate the fair value of its options. The Black-Scholes model requires several assumptions including expected dividend yield, risk-free interest rate, volatility, and term of the options. The expected dividend yield is based on historical patterns of dividend payments. The risk-free rate is based on the rate at grant date of zero-coupon U.S. Treasury Notes with a term equal to the expected term of the option. Expected volatility is estimated using a blend of historical and implied volatility. The historical component is based on historical monthly price changes. The implied volatility is obtained from market data on the Company's traded options. The expected life represents the amount of time that options granted are expected to be outstanding, based on historical and forecasted exercise behavior.

The weighted average exercise price of options granted in 2012, 2011 and 2010 was $39.51, $36.47 and $34.30 per option, respectively. The weighted average fair value of options granted in 2012, 2011 and 2010 was $5.47, $5.39 and $7.99 per option, respectively, and were determined using the following assumptions:

Years Ended December 31	**2012**	2011	2010
Expected dividend yield	**4.4%**	4.3%	4.1%
Risk-free interest rate	**1.3%**	2.5%	2.8%
Expected volatility	**25.2%**	23.4%	33.7%
Expected life (years)	**7.0**	7.0	6.8

Summarized information relative to stock option plan activity (options in thousands) is as follows:

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding January 1, 2012	230,760	$39.51		
Granted	**7,641**	**39.51**		
Exercised	**(44,177)**	**29.64**		
Forfeited	**(28,283)**	**55.20**		
Outstanding December 31, 2012	**165,941**	**$39.46**	**3.90**	**$762**
Exercisable December 31, 2012	**149,407**	**$39.64**	**3.45**	**$700**

Additional information pertaining to stock option plans is provided in the table below:

Years Ended December 31	**2012**	2011	2010
Total intrinsic value of stock options exercised	**$ 528**	$125	$177
Fair value of stock options vested	**80**	189	290
Cash received from the exercise of stock options	**1,310**	321	363

A summary of nonvested RSU and PSU activity (shares in thousands) is as follows:

	RSUs		PSUs	
	Number of Shares	Weighted Average Grant Date Fair Value	Number of Shares	Weighted Average Grant Date Fair Value
Nonvested January 1, 2012	21,145	$33.73	1,513	$31.58
Granted	**6,899**	**39.45**	**996**	**35.35**
Vested	**(4,340)**	**28.43**	**(756)**	**31.52**
Forfeited	**(961)**	**36.02**	**(105)**	**33.38**
Nonvested December 31, 2012	**22,743**	**$36.38**	**1,648**	**$33.78**

At December 31, 2012, there was $370 million of total pretax unrecognized compensation expense related to nonvested stock options, RSU and PSU awards which will be recognized over a weighted average period of 1.8 years. For segment reporting, share-based compensation costs are unallocated expenses.

14. Pension and Other Postretirement Benefit Plans

The Company has defined benefit pension plans covering eligible employees in the United States and in certain of its international subsidiaries. In December 2011, the Compensation and Benefits Committee of the Company's Board of Directors approved management's proposal to change Merck's primary U.S. defined benefit pension plans' benefit formulas to "cash balance" formulas beginning for service on or after January 1, 2013. Active participants in these plans as of December 31, 2012 are accruing pension benefits prospectively using the new cash balance formulas based on age, service, pay and interest. However, during a transition period from January 1, 2013 through December 31, 2019, participants will earn the greater of the benefit as calculated under the employee's legacy final average pay formula or their new cash balance formula. For all years of service after December 31, 2019, participants will earn future benefits under only the cash balance formula.

In addition, the Company provides medical benefits, principally to its eligible U.S. retirees and their dependents, through its other postretirement benefit plans. In December 2011, the Company approved changes to its U.S. retiree healthcare plans, including changes for certain employees to the contribution subsidy level and eligibility criteria for subsidized retiree medical coverage and the elimination of certain retiree dental coverage.

The Company uses December 31 as the year-end measurement date for all of its pension plans and other postretirement benefit plans.

Net Periodic Benefit Cost

The net periodic benefit cost for pension and other postretirement benefit plans consisted of the following components:

	Pension Benefits			Other Postretirement Benefits		
Years Ended December 31	**2012**	2011	2010	**2012**	2011	2010
Service cost	**$ 555**	$ 619	$ 584	**$ 82**	$ 110	$ 108
Interest cost	**661**	718	688	**121**	141	148
Expected return on plan assets	**(970)**	(972)	(891)	**(136)**	(142)	(132)
Net amortization	**185**	201	148	**(35)**	(17)	8
Termination benefits	**27**	59	54	**18**	29	42
Curtailments	**(10)**	(86)	(50)	**(7)**	1	(10)
Settlements	**18**	4	(1)	**—**	—	—
Net periodic benefit cost	**$ 466**	$ 543	$ 532	**$ 43**	$ 122	$ 164

The decline in net periodic benefit cost for pension and other postretirement benefit plans in 2012 as compared with 2011 and 2010 is largely attributable to the benefit plan design changes discussed above. The changes to Merck's primary U.S. defined benefit pension plans and U.S. retiree healthcare plans reduced benefit obligations at December 31, 2011 by $752 million and $150 million, respectively, with a corresponding offset to *AOCI*, which is being amortized as reduction to net periodic benefit cost over the employees' future service period (approximately 11 years).

The net periodic benefit cost attributable to U.S. pension plans included in the above table was $268 million in 2012, $406 million in 2011 and $289 million in 2010.

In connection with restructuring actions (see Note 3), termination charges were recorded in 2012, 2011 and 2010 on pension and other postretirement benefit plans related to expanded eligibility for certain employees exiting Merck. Also, in connection with these restructuring activities, curtailments were recorded in 2012, 2011 and 2010 on pension and other postretirement benefit plans.

In addition, settlements were recorded in 2012, 2011 and 2010 on certain domestic and international pension plans.

Obligations and Funded Status

Summarized information about the changes in plan assets and benefit obligation, the funded status and the amounts recorded at December 31 is as follows:

	Pension Benefits		Other Postretirement Benefits	
	2012	2011	**2012**	2011
Fair value of plan assets January 1	**$12,481**	$12,705	**$ 1,628**	$ 1,685
Actual return on plan assets	**1,739**	6	**200**	(20)
Company contributions	**1,853**	556	**48**	58
Mergers, acquisitions and divestitures	**—**	(202)	**—**	—
Effects of exchange rate changes	**3**	56	**—**	—
Benefits paid	**(673)**	(581)	**(115)**	(95)
Settlements	**(75)**	(78)	**—**	—
Other	**21**	19	**(1)**	—
Fair value of plan assets December 31	**$15,349**	$12,481	**$ 1,760**	$ 1,628
Benefit obligation January 1	**14,416**	13,978	**2,529**	2,745
Service cost	**555**	619	**82**	110
Interest cost	**661**	718	**121**	141
Mergers, acquisitions and divestitures	**—**	(180)	**—**	—
Actuarial losses (gains)	**2,660**	688	**88**	(266)
Benefits paid	**(673)**	(581)	**(115)**	(95)
Effects of exchange rate changes	**67**	53	**—**	(3)
Plan amendments	**2**	(763)	**(86)**	(150)
Curtailments	**(17)**	(150)	**1**	16
Termination benefits	**27**	59	**18**	29
Settlements	**(75)**	(78)	**—**	—
Other	**23**	53	**12**	2
Benefit obligation December 31	**$17,646**	$14,416	**$ 2,650**	$ 2,529
Funded status December 31	**$ (2,297)**	$ (1,935)	**$ (890)**	$ (901)
Recognized as:				
Other assets	**$ 355**	$ 669	**$ 506**	$ 391
Accrued and other current liabilities	**(50)**	(81)	**(9)**	(10)
Deferred income taxes and noncurrent liabilities	**(2,602)**	(2,523)	**(1,387)**	(1,282)

The fair value of U.S. pension plan assets included in the preceding table was $8.7 billion and $6.8 billion at December 31, 2012 and 2011, respectively, and the projected benefit obligation of U.S. pension plans was $10.0 billion and $8.7 billion, respectively. Approximately 44% and 40% of the Company's pension projected benefit obligation at December 31, 2012 and 2011, respectively, relates to international defined benefit plans, of which each individual plan is not significant relative to the total projected benefit obligation.

At December 31, 2012 and 2011, the accumulated benefit obligation was $15.9 billion and $12.9 billion, respectively, for all pension plans, of which $9.0 billion and $7.8 billion, respectively, related to U.S. pension plans.

For pension plans with projected benefit obligations in excess of plan assets at December 31, 2012 and 2011, the fair value of plan assets was $12.8 billion and $9.3 billion, respectively, and the benefit obligations were $15.5 billion and $11.9 billion, respectively. For those plans with accumulated benefit obligations in excess of plan assets at December 31, 2012 and 2011, the fair value of plan assets was $6.1 billion and $3.6 billion, respectively, and the accumulated benefit obligations were $7.7 billion and $5.4 billion, respectively.

Plan Assets

Entities are required to use a fair value hierarchy which maximizes the use of observable inputs and minimizes the use of unobservable inputs when measuring fair value. There are three levels of inputs used to measure fair value with Level 1 having the highest priority and Level 3 having the lowest:

Level 1 — Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 — Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 — Unobservable inputs that are supported by little or no market activity. The Level 3 assets are those whose values are determined using pricing models, discounted cash flow methodologies, or similar techniques with significant unobservable inputs, as well as instruments for which the determination of fair value requires significant judgment or estimation. At December 31, 2012 and 2011, $692 million and $637 million, respectively, or approximately 5% of the Company's pension investments at each year end, were categorized as Level 3 assets.

If the inputs used to measure the financial assets fall within more than one level described above, the categorization is based on the lowest level input that is significant to the fair value measurement of the instrument.

The fair values of the Company's pension plan assets at December 31 by asset category are as follows:

	Fair Value Measurements Using				Fair Value Measurements Using			
	Quoted Prices In Active Markets for Identical Assets (Level 1)	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Total**	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
		2012				2011		
Assets								
Cash and cash equivalents	**$ 142**	**$ 587**	**$ —**	**$ 729**	$ 93	$ 217	$ —	$ 310
Investment funds								
U.S. large cap equities	**63**	**2,899**	**—**	**2,962**	65	2,226	—	2,291
U.S. small/mid cap equities	**10**	**954**	**—**	**964**	9	710	—	719
Non-U.S. developed markets equities	**610**	**2,133**	**—**	**2,743**	390	1,735	—	2,125
Non-U.S. emerging markets equities	**121**	**771**	**—**	**892**	82	575	—	657
Government and agency obligations	**279**	**720**	**—**	**999**	119	632	—	751
Corporate obligations	**166**	**94**	**—**	**260**	112	193	—	305
Fixed income obligations	**14**	**206**	**—**	**220**	—	144	—	144
Real estate(1)	**4**	**14**	**141**	**159**	—	9	144	153
Equity securities								
U.S. large cap	**351**	**—**	**—**	**351**	330	—	—	330
U.S. small/mid cap	**1,258**	**—**	**—**	**1,258**	1,085	—	—	1,085
Non-U.S. developed markets	**668**	**—**	**—**	**668**	623	—	—	623
Fixed income securities								
Government and agency obligations	**2**	**1,052**	**—**	**1,054**	—	1,248	—	1,248
Corporate obligations	**—**	**1,008**	**—**	**1,008**	—	703	—	703
Mortgage and asset-backed securities	**—**	**269**	**—**	**269**	—	275	—	275
Other investments								
Insurance contracts(2)	**—**	**117**	**496**	**613**	—	138	428	566
Derivatives	**—**	**162**	**—**	**162**	—	141	—	141
Other	**—**	**53**	**55**	**108**	3	42	65	110
Liabilities								
Derivatives	**$ —**	**$ 70**	**$ —**	**$ 70**	$ —	$ 55	$ —	$ 55
	$3,688	**$10,969**	**$692**	**$15,349**	$2,911	$8,933	$637	$12,481

(1) *The plans' Level 3 investments in real estate funds are generally valued by market appraisals of the underlying investments in the funds.*

(2) *The plans' Level 3 investments in insurance contracts are generally valued using a crediting rate that approximates market returns and invest in underlying securities whose market values are unobservable and determined using pricing models, discounted cash flow methodologies, or similar techniques.*

The table below provides a summary of the changes in fair value, including transfers in and/or out, of all financial assets measured at fair value using significant unobservable inputs (Level 3) for the Company's pension plan assets:

	2012				2011			
	Insurance Contracts	**Real Estate**	**Other**	**Total**	Insurance Contracts	Real Estate	Other	Total
Balance January 1	**$428**	**$144**	**$ 65**	**$637**	$420	$165	$63	$648
Actual return on plan assets:								
Relating to assets still held at December 31	**35**	**20**	**(2)**	**53**	16	(7)	(2)	7
Relating to assets sold during the year	**1**	**(12)**	**5**	**(6)**	1	—	4	5
Purchases	**21**	**—**	**4**	**25**	19	13	(3)	29
Sales	**(11)**	**(1)**	**(14)**	**(26)**	(28)	(27)	3	(52)
Transfers to Level 3	**22**	**(10)**	**(3)**	**9**	—	—	—	—
Balance December 31	**$496**	**$141**	**$ 55**	**$692**	$428	$144	$65	$637

The fair values of the Company's other postretirement benefit plan assets at December 31 by asset category are as follows:

	Fair Value Measurements Using				Fair Value Measurements Using			
	Quoted Prices In Active Markets for Identical Assets (Level 1)	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Total**	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
	2012				2011			
Assets								
Cash and cash equivalents	**$ 27**	**$ 48**	**$—**	**$ 75**	$ 28	$ 40	$—	$ 68
Investment funds								
U.S. large cap equities	**—**	**275**	**—**	**275**	—	443	—	443
U.S. small/mid cap equities	**—**	**150**	**—**	**150**	—	286	—	286
Non-U.S. developed markets equities	**37**	**76**	**—**	**113**	60	101	—	161
Non-U.S. emerging markets equities	**37**	**75**	**—**	**112**	30	65	—	95
Fixed income obligations	**3**	**23**	**—**	**26**	—	34	—	34
Equity securities								
U.S. large cap	**6**	**—**	**—**	**6**	4	—	—	4
U.S. small/mid cap	**101**	**—**	**—**	**101**	101	—	—	101
Non-U.S. developed markets	**32**	**—**	**—**	**32**	94	—	—	94
Fixed income securities								
Government and agency obligations	**—**	**298**	**—**	**298**	—	76	—	76
Corporate obligations	**—**	**310**	**—**	**310**	—	208	—	208
Mortgage and asset-backed securities	**—**	**238**	**—**	**238**	—	46	—	46
Other fixed income obligations	**—**	**24**	**—**	**24**	—	12	—	12
	$243	**$1,517**	**$—**	**$1,760**	$317	$1,311	$—	$1,628

The Company has established investment guidelines for its U.S. pension and other postretirement plans to create an asset allocation that is expected to deliver a rate of return sufficient to meet the long-term obligation of each plan, given an acceptable level of risk. The target investment portfolio of the Company's U.S. pension and other postretirement benefit plans is allocated 45% to 60% in U.S. equities, 20% to 30% in international equities, 15% to 25% in fixed-income investments, and up to 8% in cash and other investments. The portfolio's equity weighting is consistent with the long-term nature of the plans' benefit obligations. The expected annual standard deviation of returns of the target portfolio, which approximates 13%, reflects both the equity allocation and the diversification benefits among the asset classes in which the portfolio invests. For non-U.S. pension plans, the targeted investment portfolio varies based on the duration of pension liabilities and local government rules and regulations. Although a significant percentage of plan assets are invested in U.S. equities, concentration risk is mitigated through the use of strategies that are diversified within management guidelines.

Expected Contributions

Contributions to the pension plans and other postretirement benefit plans during 2013 are expected to be approximately $340 million and $40 million, respectively.

Expected Benefit Payments

Expected benefit payments are as follows:

	Pension Benefits	Other Postretirement Benefits
2013	$ 643	$123
2014	636	128
2015	693	133
2016	713	138
2017	742	143
2018 — 2022	4,566	802

Expected benefit payments are based on the same assumptions used to measure the benefit obligations and include estimated future employee service.

Amounts Recognized in Other Comprehensive Income

Net loss amounts reflect experience differentials primarily relating to differences between expected and actual returns on plan assets as well as the effects of changes in actuarial assumptions. Net loss amounts in excess of certain thresholds are amortized into net pension and other postretirement benefit cost over the average remaining service life of employees. The following amounts were reflected as components of *OCI*:

	Pension Plans			Other Postretirement Benefit Plans		
Years Ended December 31	**2012**	2011	2010	**2012**	2011	2010
Net (loss) gain arising during the period	**$(1,907)**	$(1,628)	$361	**$(24)**	$106	$ 66
Prior service (cost) credit arising during the period	**(13)**	783	1	**78**	133	99
	$(1,920)	$ (845)	$362	**$ 54**	$239	$165
Net loss amortization included in benefit cost	**$ 256**	$ 196	$140	**$ 31**	$ 38	$ 55
Prior service (credit) cost amortization included in benefit cost	**(71)**	5	8	**(66)**	(55)	(47)
	$ 185	$ 201	$148	**$(35)**	$ (17)	$ 8

The estimated net loss (gain) and prior service cost (credit) amounts that will be amortized from *AOCI* into net pension and postretirement benefit cost during 2013 are $410 million and $(72) million, respectively, for pension plans and are $25 million and $(73) million, respectively, for other postretirement benefit plans.

Actuarial Assumptions

The Company reassesses its benefit plan assumptions on a regular basis. The weighted average assumptions used in determining pension plan and U.S. pension and other postretirement benefit plan information are as follows:

	Pension Plans			U.S. Pension and Other Postretirement Benefit Plans		
December 31	**2012**	2011	2010	**2012**	2011	2010
Net periodic benefit cost						
Discount rate	**4.70%**	5.20%	5.50%	**4.80%**	5.40%	5.90%
Expected rate of return on plan assets	**7.50%**	7.50%	7.60%	**8.70%**	8.70%	8.70%
Salary growth rate	**4.00%**	4.20%	4.15%	**4.50%**	4.50%	4.50%
Benefit obligation						
Discount rate	**3.90%**	4.70%	5.20%	**4.10%**	4.80%	5.40%
Salary growth rate	**4.20%**	4.00%	4.20%	**4.50%**	4.50%	4.50%

For both the pension and other postretirement benefit plans, the discount rate is evaluated on measurement dates and modified to reflect the prevailing market rate of a portfolio of high-quality fixed-income debt instruments that would provide the future cash flows needed to pay the benefits included in the benefit obligation as they come due. The expected rate of return for both the pension and other postretirement benefit plans represents the average rate of return to be earned on plan assets over the period the benefits included in the benefit obligation are to be paid and is determined on a country basis. In developing the expected rate of return within each country, long-term historical returns data are considered as well as actual returns on the plan assets and other capital markets experience. Using this reference information, the long-term return expectations for each asset category and a weighted average expected return for each country's target portfolio is developed, according to the allocation among those investment categories. The expected portfolio performance reflects the contribution of active management as appropriate. For 2013, the Company's expected rate of return will range from 6.00% to 8.75% compared to a range of 5.75% to 8.75% in 2012 for its U.S. pension and other postretirement benefit plans.

The health care cost trend rate assumptions for other postretirement benefit plans are as follows:

December 31	**2012**	2011
Health care cost trend rate assumed for next year	**7.5%**	7.9%
Rate to which the cost trend rate is assumed to decline	**5.0%**	5.0%
Year that the trend rate reaches the ultimate trend rate	**2018**	2018

A one percentage point change in the health care cost trend rate would have had the following effects:

	One Percentage Point	
	Increase	Decrease
Effect on total service and interest cost components	**$ 38**	**$ (30)**
Effect on benefit obligation	**$396**	**$(324)**

Savings Plans

The Company also maintains defined contribution savings plans in the United States. The Company matches a percentage of each employee's contributions consistent with the provisions of the plan for which the employee is eligible. Total employer contributions to these plans in 2012, 2011 and 2010 were $146 million, $166 million and $155 million, respectively.

15. Other (Income) Expense, Net

Years Ended December 31	**2012**	2011	2010
Interest income	**$ (232)**	$(145)	$ (83)
Interest expense	**714**	695	715
Exchange losses	**185**	143	214
Other, net	**449**	253	458
	$1,116	$ 946	$1,304

The increase in interest income in 2012 as compared with 2011 reflects the accretion of time value of money discounts related to certain accounts receivables, including accelerated accretion related to significant collections of accounts receivable in Spain (see Note 6). The increase in interest income in 2011 as compared with 2010 primarily reflects higher average investment balances. Exchange losses in 2010 reflect $200 million of losses due to two Venezuelan currency devaluations as discussed below. Other, net (as presented in the table above) in 2012 reflects a $493 million net charge related to the settlement of the ENHANCE Litigation (see Note 11). Other, net in 2011 reflects a $500 million charge related to the resolution of the arbitration proceeding involving the Company's rights to market *Remicade* and *Simponi* (see Note 5), a $136 million gain on the disposition of the Company's interest in the JJMCP joint venture (see Note 9), and a $127 million gain on the sale of certain manufacturing facilities and related assets (see Note 4). Other, net in 2010 reflects a $950 million charge to settle certain *Vioxx* litigation, and charges related to the settlement of certain pending AWP litigation, partially offset by $443 million of income recognized upon AstraZeneca's asset option exercise (see Note 9) and $102 million of income recognized on the settlement of certain disputed royalties.

In January 2010, the Company was required to remeasure its local currency operations in Venezuela to U.S. dollars as the Venezuelan economy was determined to be hyperinflationary. In addition, as noted above, exchange losses for 2010 reflect losses relating to Venezuelan currency devaluations. Effective January 11, 2010, the Venezuelan government devalued its currency to a two-tiered official exchange rate with an "essentials rate" and a "non-essentials rate." In December 2010, the Venezuelan government announced it would eliminate the essentials rate effective January 1, 2011. As a result of this announcement, the Company remeasured its December 31, 2010 monetary assets and liabilities at the new official rate.

Interest paid was $898 million in 2012, $600 million in 2011 and $763 million in 2010, which excludes commitment fees. Interest paid for 2011 is net of $288 million received by the Company from the termination of certain interest rate swap contracts during the year (see Note 6).

16. Taxes on Income

A reconciliation between the effective tax rate and the U.S. statutory rate is as follows:

	2012		2011		2010	
	Amount	**Tax Rate**	Amount	Tax Rate	Amount	Tax Rate
U.S. statutory rate applied to income before taxes	**$ 3,059**	**35.0%**	$ 2,567	35.0%	$ 579	35.0%
Differential arising from:						
Foreign earnings	**(1,955)**	**(22.4)**	(2,220)	(30.3)	(1,878)	(113.6)
Tax settlements	**(113)**	**(1.3)**	(721)	(9.8)	(17)	(1.0)
Unremitted foreign earnings	**(11)**	**(0.1)**	(86)	(1.2)	(217)	(13.1)
Amortization of purchase accounting adjustments	**905**	**10.3**	875	11.9	1,394	84.3
Vioxx and ENHANCE litigation settlements	**98**	**1.2**	—	—	332	20.1
Restructuring	**62**	**0.7**	163	2.2	134	8.1
U.S. health care reform legislation	**60**	**0.7**	50	0.7	147	8.9
Tax rate changes	**57**	**0.6**	(295)	(4.0)	(391)	(23.7)
IPR&D impairment charges	**40**	**0.5**	(5)	(0.1)	484	29.3
Arbitration settlement charge	**—**	**—**	177	2.4	—	—
State taxes	**31**	**0.3**	72	1.0	(42)	(2.6)
Other[1]	**207**	**2.4**	365	5.0	146	8.9
	$ 2,440	**27.9%**	$ 942	12.8%	$ 671	40.6%

[1] *Other includes the tax effect of contingency reserves, research credits and miscellaneous items.*

The foreign earnings tax rate differentials in the tax rate reconciliation above primarily reflect the impacts of operations in jurisdictions with different tax rates than the United States, particularly Singapore, Ireland, Switzerland and Puerto Rico (which operates under a tax incentive grant), where the earnings have been indefinitely reinvested, thereby yielding a favorable impact on the effective tax rate as compared with the 35% U.S. statutory rate. The foreign earnings tax rate differentials do not include the impact of IPR&D impairment charges, amortization of purchase accounting adjustments, restructuring costs and the arbitration settlement charge. These items are presented separately as they each represent a significant, separately disclosed pretax cost or charge, and a substantial portion of each of these items relates to jurisdictions with lower tax rates than the United States. Therefore, the impact of recording these expense items in lower tax rate jurisdictions is an unfavorable impact on the effective tax rate as compared to the 35% U.S. statutory rate.

Income before taxes consisted of:

Years Ended December 31	**2012**	2011	2010
Domestic	**$4,500**	$2,626	$1,154
Foreign	**4,239**	4,708	499
	$8,739	$7,334	$1,653

Taxes on income consisted of:

Years Ended December 31	**2012**	2011	2010
Current provision			
Federal	**$1,346**	$ 859	$ 399
Foreign	**651**	1,568	1,446
State	**(226)**	52	(82)
	1,771	2,479	1,763
Deferred provision			
Federal	**749**	(584)	764
Foreign	**(323)**	(683)	(1,777)
State	**243**	(270)	(79)
	669	(1,537)	(1,092)
	$2,440	$ 942	$ 671

Deferred income taxes at December 31 consisted of:

	2012		2011	
	Assets	**Liabilities**	Assets	Liabilities
Intangibles	**$ —**	**$4,584**	$ —	$5,329
Inventory related	**79**	**488**	66	325
Accelerated depreciation	**129**	**1,348**	140	1,244
Unremitted foreign earnings	**—**	**2,435**	—	2,413
Equity investments	**—**	**451**	—	280
Pensions and other postretirement benefits	**1,098**	**109**	1,179	149
Compensation related	**748**	**—**	768	—
Unrecognized tax benefits	**706**	**—**	788	—
Net operating losses and other tax credit carryforwards	**425**	**—**	538	—
Other	**1,798**	**91**	2,294	108
Subtotal	**4,983**	**9,506**	5,773	9,848
Valuation allowance	**(107)**		(246)	
Total deferred taxes	**$4,876**	**$9,506**	$5,527	$9,848
Net deferred income taxes		**$4,630**		$4,321
Recognized as:				
Deferred income taxes and other current assets	**$ 624**		$ 827	
Other assets	**527**		497	
Income taxes payable		**$ 41**		$ 19
Deferred income taxes and noncurrent liabilities		**5,740**		5,626

The Company has net operating loss ("NOL") carryforwards in several jurisdictions. As of December 31, 2012, approximately $194 million of deferred taxes on NOL carryforwards relate to foreign jurisdictions, none of which are individually significant. Approximately $107 million of valuation allowances have been established on these foreign NOL carryforwards. In addition, the Company has approximately $231 million of deferred tax assets relating to various U.S. tax credit carryforwards and NOL carryforwards, all of which are expected to be fully utilized prior to expiry.

Income taxes paid in 2012, 2011 and 2010 were $2.5 billion, $2.7 billion and $1.6 billion, respectively. Tax benefits relating to stock option exercises reflected in paid-in capital were $94 million in 2012. These amounts were not material in 2011 or 2010.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

	2012	2011	2010
Balance January 1	**$4,277**	$ 4,919	$4,743
Additions related to current year positions	**496**	695	479
Additions related to prior year positions	**58**	145	124
Reductions for tax positions of prior years[(1)]	**(320)**	(1,223)	(157)
Settlements	**(67)**	(259)	(256)
Lapse of statute of limitations	**(19)**	—	(14)
Balance December 31	**$4,425**	$ 4,277	$4,919

[(1)] *Amount for 2012 reflects the settlement with the CRA as discussed below. Amount for 2011 reflects the conclusion of the IRS examination of Merck's 2002-2005 federal income tax returns and the resolution of the interest rate swap dispute with the IRS, both as discussed below.*

If the Company were to recognize the unrecognized tax benefits of $4.4 billion at December 31, 2012, the income tax provision would reflect a favorable net impact of $3.8 billion.

The Company is under examination by numerous tax authorities in various jurisdictions globally. The Company believes that it is reasonably possible that the total amount of unrecognized tax benefits as of December 31, 2012 could decrease by up to $900 million in the next 12 months as a result of various audit closures, settlements or the expiration of the statute of limitations. The ultimate finalization of the Company's examinations with relevant taxing authorities can include formal administrative and legal proceedings, which could have a significant impact on the timing of the reversal of unrecognized tax benefits. The Company believes that its reserves for uncertain tax positions are adequate to cover existing risks or exposures.

Interest and penalties associated with uncertain tax positions amounted to a (benefit) expense of $(88) million in 2012, $(95) million in 2011 and $144 million in 2010. Liabilities for accrued interest and penalties were $1.2 billion and $1.3 billion as of December 31, 2012 and 2011, respectively.

As previously disclosed, the Canada Revenue Agency (the "CRA") had proposed adjustments for 1999 and 2000 relating to intercompany pricing matters and, in July 2011, the CRA issued assessments for other miscellaneous audit issues for tax years 2001-2004. In 2012, Merck and the CRA reached a settlement for these years that calls for Merck to pay additional Canadian tax of approximately $65 million. The Company's unrecognized tax benefits related to these matters exceeded the settlement amount and therefore the Company recorded a net $112 million tax provision benefit in 2012. A portion of the taxes paid is expected to be creditable for U.S. tax purposes. The Company had previously established reserves for these matters. The resolution of these matters did not have a material effect on the Company's results of operations, financial position or liquidity.

In April 2011, the Internal Revenue Service (the "IRS") concluded its examination of Merck's 2002-2005 federal income tax returns and as a result the Company was required to make net payments of approximately $465 million. The Company's unrecognized tax benefits for the years under examination exceeded the adjustments related to this examination period and therefore the Company recorded a net $700 million tax provision benefit in 2011. This net benefit reflects the decrease of unrecognized tax benefits for the years under examination partially offset by increases to unrecognized tax benefits for years subsequent to the examination period as a result of this settlement. The Company disagrees with the IRS treatment of one issue raised during this examination and is appealing the matter through the IRS administrative process.

In 2010, the IRS finalized its examination of Schering-Plough's 2003-2006 tax years. In this audit cycle, the Company reached an agreement with the IRS on an adjustment to income related to intercompany pricing matters. This income adjustment mostly reduced NOLs and other tax credit carryforwards. Additionally, the Company is seeking resolution of one issue raised during this examination through the IRS administrative appeals process. The Company's reserves for uncertain tax positions were adequate to cover all adjustments related to this examination period. The IRS began its examination of the 2007-2009 tax years in 2010.

In addition, various state and foreign tax examinations are in progress. For most of its other significant tax jurisdictions (both U.S. state and foreign), the Company's income tax returns are open for examination for the period 2001 through 2012.

At December 31, 2012, foreign earnings of $53.4 billion have been retained indefinitely by subsidiary companies for reinvestment; therefore, no provision has been made for income taxes that would be payable upon the distribution of such earnings and it would not be practicable to determine the amount of the related unrecognized deferred income tax liability. In addition, the Company has subsidiaries operating in Puerto Rico and Singapore under tax incentive grants that begin to expire in 2013.

17. Earnings per Share

The Company calculates earnings per share pursuant to the two-class method, which is an earnings allocation formula that determines earnings per share for common stock and participating securities according to dividends declared and participation rights in undistributed earnings. Under this method, all earnings (distributed and undistributed) are allocated to common shares and participating securities based on their respective rights to receive dividends. RSUs and certain PSUs granted before December 31, 2009 to certain management level employees (see Note 13) participate in dividends on the same basis as common shares and such dividends are nonforfeitable by the holder. As a result, these RSUs and PSUs meet the definition of a participating security. For RSUs and PSUs issued on or after January 1, 2010, dividends declared during the vesting period are payable to the employees only upon vesting and therefore such RSUs and PSUs do not meet the definition of a participating security.

The calculations of earnings per share under the two-class method are as follows:

Years Ended December 31	**2012**	2011	2010
Basic Earnings per Common Share			
Net income attributable to Merck & Co., Inc.	**$6,168**	$6,272	$ 861
Less: Income allocated to participating securities	**3**	15	2
Net income allocated to common shareholders	**$6,165**	$6,257	$ 859
Average common shares outstanding	**3,041**	3,071	3,095
	$ 2.03	$ 2.04	$ 0.28
Earnings per Common Share Assuming Dilution			
Net income attributable to Merck & Co., Inc.	**$6,168**	$6,272	$ 861
Less: Income allocated to participating securities	**3**	15	2
Net income allocated to common shareholders	**$6,165**	$6,257	$ 859
Average common shares outstanding	**3,041**	3,071	3,095
Common shares issuable(1)	**35**	23	25
Average common shares outstanding assuming dilution	**3,076**	3,094	3,120
	$ 2.00	$ 2.02	$ 0.28

(1) *Issuable primarily under share-based compensation plans.*

In 2012, 2011 and 2010, 104 million, 169 million and 174 million, respectively, of common shares issuable under share-based compensation plans were excluded from the computation of earnings per common share assuming dilution because the effect would have been antidilutive.

18. Other Comprehensive (Loss) Income

The components of *Other comprehensive (loss) income* are as follows:

	Pretax	Tax	After Tax
Year Ended December 31, 2012			
Net unrealized loss on derivatives	**$ (198)**	**$ 77**	**$ (121)**
Net loss realization	**33**	**(13)**	**20**
Derivatives	**(165)**	**64**	**(101)**
Net unrealized gain on investments	**74**	**(10)**	**64**
Net gain realization	**(13)**	**1**	**(12)**
Investments	**61**	**(9)**	**52**
Benefit plan net (loss) gain and prior service (credit) cost, net of amortization	**(1,716)**	**395**	**(1,321)**
Cumulative translation adjustment	**(99)**	**(81)**	**(180)**
	$(1,919)	**$ 369**	**$(1,550)**
Year Ended December 31, 2011			
Net unrealized loss on derivatives	$ (143)	$ 56	$ (87)
Net loss realization	83	(33)	50
Derivatives	(60)	23	(37)
Net unrealized loss on investments	(10)	5	(5)
Net gain realization	(7)	2	(5)
Investments	(17)	7	(10)
Benefit plan net (loss) gain and prior service (credit) cost, net of amortization	(422)	119	(303)
Cumulative translation adjustment	435	(1)	434
	$ (64)	$ 148	$ 84
Year Ended December 31, 2010			
Net unrealized gain on derivatives	$ 120	$ (41)	$ 79
Net loss realization	7	(3)	4
Derivatives	127	(44)	83
Net unrealized gain on investments	41	(11)	30
Net gain realization	(48)	16	(32)
Investments	(7)	5	(2)
Benefit plan net gain (loss) and prior service cost (credit), net of amortization	683	(257)	426
Cumulative translation adjustment	(835)	(121)	(956)
	$ (32)	$(417)	$ (449)

Also included in cumulative translation adjustment are pretax gains (losses) of approximately $392 million and $(1.2) billion for 2011 and 2010, respectively, relating to translation impacts of intangible assets recorded in conjunction with the Merger.

The components of *Accumulated other comprehensive loss* are as follows:

December 31	**2012**	2011
Net unrealized (loss) gain on derivatives	**$ (97)**	$ 4
Net unrealized gain on investments	**73**	21
Pension plan net loss	**(4,056)**	(2,793)
Other postretirement benefit plan net loss	**(414)**	(402)
Pension plan prior service credit	**449**	502
Other postretirement benefit plan prior service credit	**354**	347
Cumulative translation adjustment	**(991)**	(811)
	$(4,682)	$(3,132)

19. Segment Reporting

The Company's operations are principally managed on a products basis and are comprised of four operating segments – Pharmaceutical, Animal Health, Consumer Care and Alliances (which includes revenue and equity income from the Company's relationship with AZLP). The Animal Health, Consumer Care and Alliances segments are not material for separate reporting and are included in all other in the table below. The Pharmaceutical segment includes human health pharmaceutical and vaccine products marketed either directly by the Company or through joint ventures. Human health pharmaceutical products consist of therapeutic and preventive agents, generally sold by prescription, for the treatment of human disorders. The Company sells these human health pharmaceutical products primarily to drug wholesalers and retailers, hospitals, government agencies and managed health care providers such as health maintenance organizations, pharmacy benefit managers and other institutions. Vaccine products consist of preventive pediatric, adolescent and adult vaccines, primarily administered at physician offices. The Company sells these human health vaccines primarily to physicians, wholesalers, physician distributors and government entities. A large component of pediatric and adolescent vaccines is sold to the U.S. Centers for Disease Control and Prevention Vaccines for Children program, which is funded by the U.S. government. Additionally, the Company sells vaccines to the Federal government for placement into vaccine stockpiles. The Company also has animal health operations that discover, develop, manufacture and market animal health products, including vaccines, which the Company sells to veterinarians, distributors and animal producers. Additionally, the Company has consumer care operations that develop, manufacture and market over-the-counter, foot care and sun care products, which are sold through wholesale and retail drug, food chain and mass merchandiser outlets, as well as club stores and specialty channels.

The accounting policies for the segments described above are the same as those described in Note 2.

Sales of the Company's products were as follows:

	2012	2011	2010
Primary Care and Women's Health			
Cardiovascular			
Zetia	**$ 2,567**	$ 2,428	$ 2,297
Vytorin	**1,747**	1,882	2,014
Diabetes and Obesity			
Januvia	**4,086**	3,324	2,385
Janumet	**1,659**	1,363	954
Respiratory			
Singulair	**3,853**	5,479	4,987
Nasonex	**1,268**	1,286	1,219
Clarinex	**393**	621	623
Dulera	**207**	96	8
Asmanex	**185**	206	208
Women's Health and Endocrine			
Fosamax	**676**	855	926
NuvaRing	**623**	623	559
Follistim AQ	**468**	530	528
Implanon	**348**	294	236
Cerazette	**271**	268	209
Other			
Maxalt	**638**	639	550
Arcoxia	**453**	431	398
Avelox	**201**	322	316
Hospital and Specialty			
Immunology			
Remicade	**2,076**	2,667	2,714
Simponi	**331**	264	97
Infectious Disease			
Isentress	**1,515**	1,359	1,090
PegIntron	**653**	657	737
Cancidas	**619**	640	611
Victrelis	**502**	140	—
Invanz	**445**	406	362
Primaxin	**384**	515	610
Noxafil	**258**	230	198
Oncology			
Temodar	**917**	935	1,065
Emend	**489**	419	378
Other			
Cosopt/Trusopt	**444**	477	484
Bridion	**261**	201	103
Integrilin	**211**	230	266
Diversified Brands			
Cozaar/Hyzaar	**1,284**	1,663	2,104
Propecia	**424**	447	447
Zocor	**383**	456	468
Claritin Rx	**244**	314	296
Remeron	**232**	241	223
Proscar	**217**	223	216
Vasotec/Vaseretic	**192**	231	255
Vaccines(1)			
Gardasil	**1,631**	1,209	988
ProQuad/M-M-R II/Varivax	**1,273**	1,202	1,378
Zostavax	**651**	332	243
RotaTeq	**601**	651	519
Pneumovax	**580**	498	376
Other pharmaceutical(2)	**4,141**	4,035	4,622
Total Pharmaceutical segment sales	**40,601**	41,289	39,267
Other segment sales(3)	**6,412**	6,428	6,159
Total segment sales	**47,013**	47,717	45,426
Other(4)	**254**	330	561
	$47,267	$48,047	$45,987

(1) *These amounts do not reflect sales of vaccines sold in most major European markets through the Company's joint venture, Sanofi Pasteur MSD, the results of which are reflected in* Equity income from affiliates. *These amounts do, however, reflect supply sales to Sanofi Pasteur MSD.*

(2) *Other pharmaceutical primarily reflects sales of other human health pharmaceutical products, including products within the franchises not listed separately.*

(3) *Represents the non-reportable segments of Animal Health, Consumer Care and Alliances. The Alliances segment includes revenue from the Company's relationship with AZLP.*

(4) *Other revenues are primarily comprised of miscellaneous corporate revenues, third-party manufacturing sales, sales related to divested products or businesses and other supply sales not included in segment results.*

Consolidated revenues by geographic area where derived are as follows:

Years Ended December 31	**2012**	2011	2010
United States	**$20,392**	$20,495	$20,226
Europe, Middle East and Africa	**12,990**	13,782	13,497
Japan	**5,102**	4,835	3,768
Other	**8,783**	8,935	8,496
	$47,267	$48,047	$45,987

A reconciliation of total segment profits to consolidated *Income before taxes* is as follows:

Years Ended December 31	**2012**	2011	2010
Segment profits:			
Pharmaceutical segment	**$25,852**	$25,617	$ 23,864
Other segments	**3,163**	2,995	2,849
Total segment profits	**29,015**	28,612	26,713
Other profits (losses)	**26**	(11)	(8)
Unallocated:			
Interest income	**232**	145	83
Interest expense	**(714)**	(695)	(715)
Equity income from affiliates	**102**	41	(18)
Depreciation and amortization	**(2,059)**	(2,412)	(2,671)
Research and development	**(7,240)**	(7,527)	(10,710)
Amortization of purchase accounting adjustments	**(4,872)**	(5,000)	(6,566)
Restructuring costs	**(664)**	(1,306)	(985)
Net charge related to settlement of ENHANCE Litigation	**(493)**	—	—
Arbitration settlement charge	**—**	(500)	—
Vioxx Liability Reserve	**—**	—	(950)
Gain on AstraZeneca asset option exercise	**—**	—	443
Other unallocated, net	**(4,594)**	(4,013)	(2,963)
	$ 8,739	$ 7,334	$ 1,653

Segment profits are comprised of segment sales less standard costs and certain operating expenses directly incurred by the segments. For internal management reporting presented to the chief operating decision maker, Merck does not allocate materials and production costs, other than standard costs, the majority of research and development expenses or general and administrative expenses, nor the cost of financing these activities. Separate divisions maintain responsibility for monitoring and managing these costs, including depreciation related to fixed assets utilized by these divisions and, therefore, they are not included in segment profits. In addition, costs related to restructuring activities, as well as the amortization of purchase accounting adjustments are not allocated to segments.

Other profits (losses) are primarily comprised of miscellaneous corporate profits (losses), as well as operating profits (losses) related to third-party manufacturing sales, divested products or businesses and other supply sales.

Other unallocated, net includes expenses from corporate and manufacturing cost centers, product intangible asset impairment charges, gain or losses on sales of businesses and other miscellaneous income or expense items.

Equity income from affiliates and depreciation and amortization included in segment profits is as follows:

	Pharmaceutical	All Other	Total
Year Ended December 31, 2012			
Included in segment profits:			
Equity income from affiliates	**$ 36**	**$504**	**$ 540**
Depreciation and amortization	**(25)**	**(20)**	**(45)**
Year Ended December 31, 2011			
Included in segment profits:			
Equity income from affiliates	59	510	569
Depreciation and amortization	(51)	(20)	(71)
Year Ended December 31, 2010			
Included in segment profits:			
Equity income from affiliates	90	515	605
Depreciation and amortization	(101)	(17)	(118)

Property, plant and equipment, net by geographic area where located is as follows:

Years Ended December 31	**2012**	2011	2010
United States	**$10,490**	$10,646	$11,078
Europe, Middle East and Africa	**3,688**	3,780	4,014
Japan	**243**	279	315
Other	**1,609**	1,592	1,675
	$16,030	$16,297	$17,082

The Company does not disaggregate assets on a products and services basis for internal management reporting and, therefore, such information is not presented.

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of Merck & Co., Inc.:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, comprehensive income, equity and cash flows present fairly, in all material respects, the financial position of Merck & Co., Inc. and its subsidiaries at December 31, 2012 and December 31, 2011, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2012 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, Merck maintained, in all material respects, effective internal control over financial reporting as of December 31, 2012, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Merck's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report under Item 9A. Our responsibility is to express opinions on these financial statements and on Merck's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

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

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

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Florham Park, New Jersey
February 26, 2013

(b) Supplementary Data

Selected quarterly financial data for 2012 and 2011 are contained in the Condensed Interim Financial Data table below.

Condensed Interim Financial Data (Unaudited)

($ in millions except per share amounts)	4th Q[(1)]	3rd Q	2nd Q[(2)]	1st Q[(3)]
2012[(4)]				
Sales	**$11,738**	**$11,488**	**$12,311**	**$11,731**
Materials and production	**4,160**	**4,137**	**4,112**	**4,037**
Marketing and administrative	**3,390**	**3,063**	**3,249**	**3,074**
Research and development	**2,224**	**1,918**	**2,165**	**1,862**
Restructuring costs	**191**	**110**	**144**	**219**
Equity income from affiliates	**(231)**	**(158)**	**(142)**	**(110)**
Other (income) expense, net	**669**	**200**	**103**	**142**
Income before taxes	**1,335**	**2,218**	**2,680**	**2,507**
Net income attributable to Merck & Co., Inc.	**908**	**1,729**	**1,793**	**1,738**
Basic earnings per common share attributable to Merck & Co., Inc. common shareholders	**$ 0.30**	**$ 0.57**	**$ 0.59**	**$ 0.57**
Earnings per common share assuming dilution attributable to Merck & Co., Inc. common shareholders	**$ 0.30**	**$ 0.56**	**$ 0.58**	**$ 0.56**
2011[(4)]				
Sales	$12,294	$12,022	$12,151	$11,580
Materials and production	4,176	4,352	4,284	4,059
Marketing and administrative	3,704	3,340	3,525	3,164
Research and development	2,419	1,954	1,936	2,158
Restructuring costs	533	119	668	(14)
Equity income from affiliates	(257)	(161)	(55)	(138)
Other (income) expense, net	139	66	121	622
Income before taxes	1,580	2,352	1,672	1,729
Net income attributable to Merck & Co., Inc.	1,512	1,692	2,024	1,043
Basic earnings per common share attributable to Merck & Co., Inc. common shareholders	$ 0.50	$ 0.55	$ 0.65	$ 0.34
Earnings per common share assuming dilution attributable to Merck & Co., Inc. common shareholders	$ 0.49	$ 0.55	$ 0.65	$ 0.34

(1) *Amounts for 2012 include a net charge related to a litigation settlement (see Note 11).*

(2) *Amounts for 2011 include a net benefit relating to the settlement of a federal income tax audit (see Note 16).*

(3) *Amounts for 2011 include a charge relating to the resolution of the arbitration proceeding with J&J (see Note 5).*

(4) *Amounts for 2012 and 2011 reflect acquisition-related costs (see Note 8) and the impact of restructuring actions (see Note 3).*

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

Not applicable.

Item 9A. Controls and Procedures.

Management of the Company, with the participation of its Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the Company's disclosure controls and procedures. Based on their evaluation, as of the end of the period covered by this Form 10-K, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Act")) are effective.

Management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rule 13a-15(f) of the Act. Management conducted an evaluation of the effectiveness of internal control over financial reporting based on the framework in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management concluded that internal control over financial reporting was effective as of December 31, 2012. PricewaterhouseCoopers LLP, an independent registered public accounting firm, has performed its own assessment of the effectiveness of the Company's internal control over financial reporting and its attestation report is included in this Form 10-K filing.

Management's Report

Management's Responsibility for Financial Statements

Responsibility for the integrity and objectivity of the Company's financial statements rests with management. The financial statements report on management's stewardship of Company assets. These statements are prepared in conformity with generally accepted accounting principles and, accordingly, include amounts that are based on management's best estimates and judgments. Nonfinancial information included in the Annual Report on Form 10-K has also been prepared by management and is consistent with the financial statements.

To assure that financial information is reliable and assets are safeguarded, management maintains an effective system of internal controls and procedures, important elements of which include: careful selection, training and development of operating and financial managers; an organization that provides appropriate division of responsibility; and communications aimed at assuring that Company policies and procedures are understood throughout the organization. A staff of internal auditors regularly monitors the adequacy and application of internal controls on a worldwide basis.

To ensure that personnel continue to understand the system of internal controls and procedures, and policies concerning good and prudent business practices, annually all employees of the Company are required to complete Code of Conduct training, which includes financial stewardship. This training reinforces the importance and understanding of internal controls by reviewing key corporate policies, procedures and systems. In addition, the Company has compliance programs, including an ethical business practices program to reinforce the Company's long-standing commitment to high ethical standards in the conduct of its business.

The financial statements and other financial information included in the Annual Report on Form 10-K fairly present, in all material respects, the Company's financial condition, results of operations and cash flows. Our formal certification to the Securities and Exchange Commission is included in this Form 10-K filing.

Management's Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rule 13a-15(f) under the Securities Exchange Act of 1934. The Company's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles in the United States of America. Management conducted an evaluation of the effectiveness of internal control over financial reporting based on the framework in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management concluded that internal control over financial reporting was effective as of December 31, 2012.

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

The effectiveness of the Company's internal control over financial reporting as of December 31, 2012, has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which appears herein.

Kenneth C. Frazier
Chairman, President
and Chief Executive Officer

Peter N. Kellogg
Executive Vice President
and Chief Financial Officer

Item 9B. Other Information.

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance.

The required information on directors and nominees is incorporated by reference from the discussion under Proposal 1. Election of Directors of the Company's Proxy Statement for the Annual Meeting of Shareholders to be held May 28, 2013. Information on executive officers is set forth in Part I of this document on pages 33 through 36.

The required information on compliance with Section 16(a) of the Securities Exchange Act of 1934 is incorporated by reference from the discussion under the heading "Section 16(a) Beneficial Ownership Reporting Compliance" of the Company's Proxy Statement for the Annual Meeting of Shareholders to be held May 28, 2013.

The Company has a Code of Conduct — *Our Values and Standards* applicable to all employees, including the principal executive officer, principal financial officer, and principal accounting officer. The Code of Conduct is available on the Company's website at *www.merck.com/about/code_of_conduct.pdf*. Every Merck employee is responsible for adhering to business practices that are in accordance with the law and with ethical principles that reflect the highest standards of corporate and individual behavior. A printed copy will be sent, without charge, to any shareholder who requests it by writing to the Chief Ethics and Compliance Officer of Merck & Co., Inc., One Merck Drive, Whitehouse Station, NJ 08889-0100.

The required information on the identification of the audit committee and the audit committee financial expert is incorporated by reference from the discussion under the heading "Board Committees" of the Company's Proxy Statement for the Annual Meeting of Shareholders to be held May 28, 2013.

Item 11. Executive Compensation.

The information required on executive compensation is incorporated by reference from the discussion under the headings "Compensation Discussion and Analysis", "Summary Compensation Table", "All Other Compensation" table, "Grants of Plan-Based Awards" table, "Outstanding Equity Awards" table, "Option Exercises and Stock Vested" table, "Pension Benefits" table, Nonqualified Deferred Compensation and related table, Potential Payments Upon Termination or Change in Control, including the discussion under the subheadings "Separation", "Individual Agreements" and "Change in Control", as well as all footnote information to the various tables, of the Company's Proxy Statement for the Annual Meeting of Shareholders to be held May 28, 2013.

The required information on director compensation is incorporated by reference from the discussion under the heading "Director Compensation" and related "Director Compensation" table and "Schedule of Director Fees" table of the Company's Proxy Statement for the Annual Meeting of Shareholders to be held May 28, 2013.

The required information under the headings "Compensation Committee Interlocks and Insider Participation" and "Compensation and Benefits Committee Report" is incorporated by reference from the Company's Proxy Statement for the Annual Meeting of Shareholders to be held May 28, 2013.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

Information with respect to securities authorized for issuance under equity compensation plans is set forth in Part II of this document on page 38. Information with respect to security ownership of certain beneficial owners and management is incorporated by reference from the discussion under the heading "Security Ownership of Certain Beneficial Owners and Management" of the Company's Proxy Statement for the Annual Meeting of Shareholders to be held May 28, 2013.

Item 13. Certain Relationships and Related Transactions, and Director Independence.

The required information on transactions with related persons is incorporated by reference from the discussion under the heading "Related Person Transactions" of the Company's Proxy Statement for the Annual Meeting of Shareholders to be held May 28, 2013.

The required information on director independence is incorporated by reference from the discussion under the heading “Independence of Directors” of the Company’s Proxy Statement for the Annual Meeting of Shareholders to be held May 28, 2013.

Item 14. Principal Accountant Fees and Services.

The information required for this item is incorporated by reference from the discussion under “Audit Committee” beginning with the caption “Pre-Approval Policy for Services of Independent Registered Public Accounting Firm” through “All Other Fees” of the Company’s Proxy Statement for the Annual Meeting of Shareholders to be held May 28, 2013.

PART IV

Item 15. Exhibits and Financial Statement Schedules.

(a) The following documents are filed as part of this Form 10-K

1. Financial Statements

Consolidated statement of income for the years ended December 31, 2012, 2011 and 2010

Consolidated statement of comprehensive income for the years ended December 31, 2012, 2011 and 2010

Consolidated balance sheet as of December 31, 2012 and 2011

Consolidated statement of equity for the years ended December 31, 2012, 2011 and 2010

Consolidated statement of cash flows for the years ended December 31, 2012, 2011 and 2010

Notes to consolidated financial statements

Report of PricewaterhouseCoopers LLP, independent registered public accounting firm

2. Financial Statement Schedules

Schedules are omitted because they are either not required or not applicable.

Financial statements of affiliates carried on the equity basis have been omitted because, considered individually or in the aggregate, such affiliates do not constitute a significant subsidiary.

3. Exhibits

Exhibit Number		Description
2.1	—	Master Restructuring Agreement dated as of June 19, 1998 between Astra AB, Merck & Co., Inc., Astra Merck Inc., Astra USA, Inc., KB USA, L.P., Astra Merck Enterprises, Inc., KBI Sub Inc., Merck Holdings, Inc. and Astra Pharmaceuticals, L.P. (Portions of this Exhibit are subject to a request for confidential treatment filed with the Commission) — Incorporated by reference to MSD's Form 10-Q Quarterly Report for the period ended June 30, 1998
2.2	—	Agreement and Plan of Merger by and among Merck & Co., Inc., Schering-Plough Corporation, Blue, Inc. and Purple, Inc. dated as of March 8, 2009 — Incorporated by reference to Schering-Plough's Current Report on Form 8-K filed March 11, 2009
2.3	—	Share Purchase Agreement, dated July 29, 2009, by and among Merck & Co., Inc., Merck SH Inc., Merck Sharp & Dohme (Holdings) Limited and sanofi-aventis — Incorporated by reference to MSD's Current Report on Form 8-K dated July 31, 2009
3.1	—	Restated Certificate of Incorporation of Merck & Co., Inc. (November 3, 2009) — Incorporated by reference to Merck & Co., Inc.'s Current Report on Form 8-K filed November 4, 2009
3.2	—	By-Laws of Merck & Co., Inc. (effective January 1, 2013) — Incorporated by reference to Merck & Co., Inc.'s Current Report on Form 8-K filed December 21, 2011
4.1	—	Indenture, dated as of April 1, 1991, between Merck & Co., Inc. and Morgan Guaranty Trust Company of New York, as Trustee — Incorporated by reference to Exhibit 4 to MSD's Registration Statement on Form S-3 (No. 33-39349)
4.2	—	First Supplemental Indenture, dated as of October 1, 1997, between Merck & Co., Inc. and First Trust of New York, National Association, as Trustee — Incorporated by reference to Exhibit 4(b) to MSD's Registration Statement on Form S-3 (No. 333-36383)
4.3	—	Second Supplemental Indenture, dated November 3, 2009, among Merck Sharp & Dohme Corp., Merck & Co., Inc. and U.S. Bank Trust National Association, as Trustee — Incorporated by reference to Exhibit 4.3 to Merck & Co., Inc.'s Current Report on Form 8-K filed November 4, 2009
4.4	—	Indenture, dated November 26, 2003, between Schering-Plough and The Bank of New York as Trustee — Incorporated by reference to Exhibit 4.1 to Schering-Plough's Current Report on Form 8-K filed November 28, 2003
4.5	—	First Supplemental Indenture (including Form of Note), dated November 26, 2003 — Incorporated by reference to Exhibit 4.2 to Schering-Plough's Current Report on Form 8-K filed November 28, 2003
4.6	—	Second Supplemental Indenture (including Form of Note), dated November 26, 2003 —Incorporated by reference to Exhibit 4.3 to Schering-Plough's Current Report on Form 8-K filed November 28, 2003
4.7	—	Third Supplemental Indenture (including Form of Note), dated September 17, 2007 — Incorporated by reference to Exhibit 4.1 to Schering-Plough's Current Report on Form 8-K filed September 17, 2007
4.8	—	Fourth Supplemental Indenture (including Form of Note), dated October 1, 2007 — Incorporated by reference to Exhibit 4.1 to Schering-Plough's Current Report on Form 8-K filed October 2, 2007
4.9	—	Fifth Supplemental Indenture, dated November 3, 2009, among Merck Sharp & Dohme Corp., Merck & Co., Inc. and The Bank of New York Mellon, as Trustee — Incorporated by reference to Exhibit 4.4 to Merck & Co., Inc.'s Current Report on Form 8-K filed November 4, 2009
4.10	—	Indenture, dated as of January 6, 2010, between Merck & Co., Inc. and U.S. Bank Trust National Association, as Trustee — Incorporated by reference to Exhibit 4.1 to Merck & Co., Inc.'s Current Report on Form 8-K filed December 10, 2010
4.11	—	Third Supplemental Indenture, dated May 1, 2012, among Merck Sharp & Dohme Corp., Schering Corporation, Merck & Co., Inc. and U.S. Bank Trust National Association, as Trustee — Incorporated by reference to Merck & Co., Inc.'s Form 10-Q Quarterly Report for the quarter year ended March 31, 2012
*10.1	—	Executive Incentive Plan (as amended effective February 27, 1996) — Incorporated by reference to MSD's Form 10-K Annual Report for the fiscal year ended December 31, 1995

Exhibit Number		Description
*10.2	—	Merck & Co., Inc. Deferral Program Including the Base Salary Deferral Plan (Amended and Restated effective January 1, 2013)
*10.3	—	Merck Sharp & Dohme Corp. 2001 Incentive Stock Plan (amended and restated as of November 3, 2009) — Incorporated by reference to Exhibit 10.9 to Merck & Co., Inc.'s Current Report on Form 8-K filed November 4, 2009
*10.4	—	Merck Sharp & Dohme Corp. 2004 Incentive Stock Plan (amended and restated as of November 3, 2009) — Incorporated by reference to Exhibit 10.8 to Merck & Co., Inc.'s Current Report on Form 8-K filed November 4, 2009
*10.5	—	Merck Sharp & Dohme Corp. 2007 Incentive Stock Plan (effective as amended and restated as of November 3, 2009) — Incorporated by reference to Exhibit 10.7 to Merck & Co., Inc.'s Current Report on Form 8-K filed November 4, 2009
*10.6	—	Amendment One to the Merck Sharp & Dohme Corp. 2007 Incentive Stock Plan (effective February 15, 2010) — Incorporated by reference to Exhibit 10.2 to Merck & Co., Inc.'s Current Report on Form 8-K filed February 18, 2010
*10.7	—	2002 Stock Incentive Plan (as amended to February 25, 2003) — Incorporated by reference to Exhibit 10(d) to Schering-Plough's 10-K for the year ended December 31, 2002
*10.8	—	Merck & Co., Inc. Schering-Plough 2006 Stock Incentive Plan (as amended and restated, effective November 3, 2009) — Incorporated by reference to Exhibit 10.13 to Merck & Co., Inc.'s Current Report on Form 8-K filed November 4, 2009
*10.9	—	Merck & Co., Inc. 2010 Incentive Stock Plan (effective as of May 1, 2010) — Incorporated by reference to Merck & Co., Inc.'s Schedule 14A filed April 12, 2010
*10.10	—	Stock option terms for a non-qualified stock option under the Merck Sharp & Dohme Corp. 2007 Incentive Stock Plan and the Schering-Plough 2006 Stock Incentive Plan — Incorporated by reference to Exhibit 10.3 to Merck & Co., Inc.'s Current Report on Form 8-K filed February 15, 2010
*10.11	—	Restricted stock unit terms for annual grant under the Merck Sharp & Dohme Corp. 2007 Incentive Stock Plan and the Schering-Plough 2006 Stock Incentive Plan — Incorporated by reference to Exhibit 10.4 to Merck & Co., Inc.'s Current Report on Form 8-K filed February 15, 2010
*10.12	—	Restricted stock unit terms for 2011 grants for Richard T. Clark under the Merck & Co., Inc. 2010 Incentive Stock Plan — Incorporated by reference to Merck & Co.'s Form 10-Q Quarterly Report for the period ended March 31, 2011
*10.13	—	Stock option terms for 2011 quarterly and annual non-qualified option grants under the Merck & Co., Inc. 2010 Incentive Stock Plan — Incorporated by reference to Merck & Co., Inc.'s Form 10-Q Quarterly Report for the period ended March 31, 2011
*10.14	—	Restricted stock unit terms for 2011 quarterly and annual grants under the Merck & Co., Inc. 2010 Incentive Stock Plan — Incorporated by reference to Merck & Co., Inc.'s Form 10-Q Quarterly Report for the period ended March 31, 2011
*10.15	—	Form of Performance share unit terms for 2011 and 2012 grants under the Merck & Co., Inc. 2010 Incentive Stock Plan
*10.16	—	Stock option terms for 2012 quarterly and annual non-qualified option grants under the Merck & Co., Inc. 2010 Incentive Stock Plan — Incorporated by reference to Merck & Co., Inc.'s Form 10-K Annual Report for the fiscal year ended December 31, 2011
*10.17	—	Restricted stock unit terms for 2012 quarterly and annual grants under the Merck & Co., Inc. 2010 Incentive Stock Plan — Incorporated by reference to Merck & Co., Inc.'s Form 10-K Annual Report for the fiscal year ended December 31, 2011
*10.18	—	Performance share unit terms for 2012 grants under the Merck & Co., Inc. 2010 Incentive Stock Plan — Incorporated by reference to Merck & Co., Inc.'s Form 10-Q Quarterly Report for the period ended March 31, 2012
*10.19	—	Form of Stock option agreement for 2013 and later quarterly and annual non-qualified option grants under the Merck & Co., Inc. 2010 Incentive Stock Plan
*10.20	—	Form of Restricted stock unit agreement for 2013 and later quarterly and annual grants under the Merck & Co., Inc. 2010 Incentive Stock Plan

Exhibit Number		Description
*10.21	—	Merck & Co., Inc. Change in Control Separation Benefits Plan — Incorporated by reference to Merck & Co., Inc.'s Current Report on Form 8-K dated November 23, 2009
*10.22	—	Amendment One to Merck & Co., Inc. Change in Control Separation Benefits Plan (effective February 15, 2010) — Incorporated by reference to Exhibit 10.1 to Merck & Co., Inc.'s Current Report on Form 8-K filed February 18, 2010
*10.23	—	Merck & Co., Inc. Change in Control Separation Benefits Plan (Effective as Amended and Restated, as of January 1, 2013) — Incorporated by reference to Merck & Co., Inc.'s Current Report on Form 8-K dated November 29, 2012
*10.24	—	Merck & Co., Inc. U.S. Separation Benefits Plan (effective as of January 1, 2012) — Incorporated by reference to Merck & Co., Inc.'s Form 10-K Annual Report for the fiscal year ended December 31, 2011
*10.25	—	Merck & Co., Inc. U.S. Separation Benefits Plan (effective as of January 1, 2013)
*10.26	—	Merck & Co., Inc. 2001 Non-Employee Directors Stock Option Plan (amended and restated as of November 3, 2009) — Incorporated by reference to Exhibit 10.11 to Merck & Co., Inc.'s Current Report on Form 8-K filed November 4, 2009
*10.27	—	Merck & Co., Inc. 2006 Non-Employee Directors Stock Option Plan (amended and restated as of November 3, 2009) — Incorporated by reference to Exhibit 10.5 to Merck & Co., Inc.'s Current Report on Form 8-K filed November 4, 2009
*10.28	—	Merck & Co., Inc. 2010 Non-Employee Directors Stock Option Plan (amended and restated as of December 1, 2010) — Incorporated by reference to Merck & Co., Inc.'s Form 10-K Annual Report for the fiscal year ended December 31, 2010
*10.29	—	Retirement Plan for the Directors of Merck & Co., Inc. (amended and restated June 21, 1996) — Incorporated by reference to MSD's Form 10-Q Quarterly Report for the period ended June 30, 1996
*10.30	—	Merck & Co., Inc. Plan for Deferred Payment of Directors' Compensation (effective as amended and restated as of December 1, 2010) — Incorporated by reference to Merck & Co., Inc.'s Form 10-K Annual Report for the fiscal year ended December 31, 2010
*10.31	—	Offer Letter between Merck & Co., Inc. and Peter S. Kim, dated December 15, 2000 —Incorporated by reference to MSD's Form 10-K Annual Report for the fiscal year ended December 31, 2003
*10.32	—	Offer Letter between Merck & Co., Inc. and Peter N. Kellogg, dated June 18, 2007 —Incorporated by reference to MSD's Current Report on Form 8-K dated June 28, 2007
*10.33	—	Form of employment agreement effective upon a change of control between Schering-Plough and certain executives for new agreements beginning in January 1, 2008 — Incorporated by reference to Exhibit 10(e)(xv) to Schering-Plough's 10-K for the year ended December 31, 2008
10.34	—	Share Purchase Agreement between Akzo Nobel N.V., Schering-Plough International C.V., and Schering-Plough Corporation — Incorporated by reference to Exhibit 10.1 to Schering-Plough's 8-K filed October 2, 2007
10.35	—	Amended and Restated License and Option Agreement dated as of July 1, 1998 between Astra AB and Astra Merck Inc. — Incorporated by reference to MSD's Form 10-Q Quarterly Report for the period ended June 30, 1998
10.36	—	KBI Shares Option Agreement dated as of July 1, 1998 by and among Astra AB, Merck & Co., Inc. and Merck Holdings, Inc. — Incorporated by reference to MSD's Form 10-Q Quarterly Report for the period ended June 30, 1998
10.37	—	Amended and Restated KBI Shares Option Agreement dated as of June 26, 2012 by and among AstraZeneca AB, Merck Sharp & Dohme Corp. and Merck Holdings LLC — Incorporated by reference to Merck & Co., Inc.'s Form 10-Q Quarterly Report for the period ended September 30, 2012
10.38	—	KBI-E Asset Option Agreement dated as of July 1, 1998 by and among Astra AB, Merck & Co., Inc., Astra Merck Inc. and Astra Merck Enterprises Inc. — Incorporated by reference to MSD's Form 10-Q Quarterly Report for the period ended June 30, 1998
10.39	—	KBI Supply Agreement dated as of July 1, 1998 between Astra Merck Inc. and Astra Pharmaceuticals, L.P. (Portions of this Exhibit are subject to a request for confidential treatment filed with the Commission). — Incorporated by reference to MSD's Form 10-Q Quarterly Report for the period ended June 30, 1998

Exhibit Number		Description
10.40	—	Second Amended and Restated Manufacturing Agreement dated as of July 1, 1998 among Merck & Co., Inc., Astra AB, Astra Merck Inc. and Astra USA, Inc. — Incorporated by reference to MSD's Form 10-Q Quarterly Report for the period ended June 30, 1998
10.41	—	Limited Partnership Agreement dated as of July 1, 1998 between KB USA, L.P. and KBI Sub Inc. — Incorporated by reference to MSD's Form 10-Q Quarterly Report for the period ended June 30, 1998
10.42	—	Distribution Agreement dated as of July 1, 1998 between Astra Merck Enterprises Inc. and Astra Pharmaceuticals, L.P. — Incorporated by reference to MSD's Form 10-Q Quarterly Report for the period ended June 30, 1998
10.43	—	Agreement to Incorporate Defined Terms dated as of June 19, 1998 between Astra AB, Merck & Co., Inc., Astra Merck Inc., Astra USA, Inc., KB USA, L.P., Astra Merck Enterprises Inc., KBI Sub Inc., Merck Holdings, Inc. and Astra Pharmaceuticals, L.P. — Incorporated by reference to MSD's Form 10-Q Quarterly Report for the period ended June 30, 1998
10.44	—	Form of Voting Agreement made and entered into as of October 30, 2006 by and between Merck & Co., Inc. and Sirna Therapeutics, Inc. — Incorporated by reference to MSD's Current Report on Form 8-K dated October 30, 2006
10.45	—	Commitment Letter by and among Merck & Co., Inc., J.P. Morgan Securities Inc. and JPMorgan Chase Bank, N.A. dated as of March 8, 2009 — Incorporated by reference to MSD's Current Report on Form 8-K dated March 8, 2009
10.46	—	Incremental Credit Agreement dated as of May 6, 2009, among Merck & Co., Inc., the Guarantors and Lenders party thereto, and JPMorgan Chase Bank, N.A., as Administrative Agent — Incorporated by reference to MSD's Current Report on Form 8-K dated May 6, 2009
10.47	—	Asset Sale Facility Agreement dated as of May 6, 2009, among Merck & Co., Inc., the Guarantors and Lenders party thereto, and JPMorgan Chase Bank, N.A., as Administrative Agent — Incorporated by reference to MSD's Current Report on Form 8-K dated May 6, 2009
10.48	—	Bridge Loan Agreement dated as of May 6, 2009, among Merck & Co., Inc., the Guarantors and Lenders party thereto, and JPMorgan Chase Bank, N.A., as Administrative Agent — Incorporated by reference to MSD's Current Report on Form 8-K dated May 6, 2009
10.49	—	Amendment No. 1 to Amended and Restated Five-Year Credit Agreement dated as of April 20, 2009 among Merck & Co., Inc., the Lenders party thereto and Citicorp USA, Inc., as Administrative Agent — Incorporated by reference to Exhibit 10.1 to Merck & Co., Inc.'s Current Report on Form 8-K filed November 4, 2009
10.50	—	Guarantee and Joinder Agreement dated as of November 3, 2009 by Merck & Co., Inc., the Guarantor, for the benefit of the Guaranteed Parties — Incorporated by reference to Exhibit 10.3 to Merck & Co., Inc.'s Current Report on Form 8-K filed November 4, 2009
10.51	—	Guarantor Joinder Agreement dated as of November 3, 2009, by Merck & Co., Inc., the Guarantor and JPMorgan Chase Bank, N.A., as Administrative Agent — Incorporated by reference to Exhibit 10.4 to Merck & Co., Inc.'s Current Report on Form 8-K filed November 4, 2009
10.52	—	Call Option Agreement, dated July 29, 2009, by and among Merck & Co., Inc., Schering-Plough Corporation and sanofi-aventis — Incorporated by reference to MSD's Current Report on Form 8-K dated July 31, 2009
10.53	—	Termination Agreement, dated as of September 17, 2009, by and among Merck & Co., Inc., Merck SH Inc., Merck Sharp & Dohme (Holdings) Limited, sanofi-aventis, sanofi 4 and Merial Limited — Incorporated by reference to MSD's Current Report on Form 8-K dated September 21, 2009
10.54	—	Letter Agreement dated April 14, 2003 relating to Consent Decree — Incorporated by reference to Exhibit 99.3 to Schering-Plough's 10-Q for the period ended March 31, 2003
10.55	—	Distribution agreement between Schering-Plough and Centocor, Inc., dated April 3, 1998 — Incorporated by reference to Exhibit 10(u) to Schering-Plough's Amended 10-K for the year ended December 31, 2003, filed May 3, 2004†
10.56	—	Amendment Agreement to the Distribution Agreement between Centocor, Inc., CAN Development, LLC, and Schering-Plough (Ireland) Company — Incorporated by reference to Exhibit 10.1 to Schering-Plough's Current Report on Form 8-K filed December 21, 2007†

Exhibit Number		Description
12	—	Computation of Ratios of Earnings to Fixed Charges
21	—	Subsidiaries of Merck & Co., Inc.
23.1	—	Consent of Independent Registered Public Accounting Firm — Contained on page 148 of this Report
24.1	—	Power of Attorney
24.2	—	Certified Resolution of Board of Directors
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	—	The following materials from Merck & Co., Inc.'s Annual Report on Form 10-K for the fiscal year ended December 31, 2012, formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Statement of Income, (ii) the Consolidated Statement of Comprehensive Income, (iii) the Consolidated Balance Sheet, (iv) the Consolidated Statement of Cash Flows, and (v) Notes to Consolidated Financial Statements.

* *Management contract or compensatory plan or arrangement.*

† *Certain portions of the exhibit have been omitted pursuant to a request for confidential treatment. The non-public information has been filed separately with the Securities and Exchange Commission pursuant to rule 24b-2 under the Securities Exchange Act of 1934, as amended.*

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: February 28, 2013

MERCK & CO., INC.

By: KENNETH C. FRAZIER
(Chairman, President and Chief Executive Officer)

By: /S/ GERALYN S. RITTER
Geralyn S. Ritter
(Attorney-in-Fact)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Signatures	Title	Date
KENNETH C. FRAZIER	Chairman, President and Chief Executive Officer; Principal Executive Officer; Director	February 28, 2013
PETER N. KELLOGG	Executive Vice President and Chief Financial Officer; Principal Financial Officer	February 28, 2013
JOHN CANAN	Senior Vice President Finance-Global Controller; Principal Accounting Officer	February 28, 2013
LESLIE A. BRUN	Director	February 28, 2013
THOMAS R. CECH	Director	February 28, 2013
THOMAS H. GLOCER	Director	February 28, 2013
WILLIAM B. HARRISON, JR.	Director	February 28, 2013
C. ROBERT KIDDER	Director	February 28, 2013
ROCHELLE B. LAZARUS	Director	February 28, 2013
CARLOS E. REPRESAS	Director	February 28, 2013
PATRICIA F. RUSSO	Director	February 28, 2013
CRAIG B. THOMPSON	Director	February 28, 2013
WENDELL P. WEEKS	Director	February 28, 2013
PETER C. WENDELL	Director	February 28, 2013

Geralyn S. Ritter, by signing her name hereto, does hereby sign this document pursuant to powers of attorney duly executed by the persons named, filed with the Securities and Exchange Commission as an exhibit to this document, on behalf of such persons, all in the capacities and on the date stated, such persons including a majority of the directors of the Company.

By: /S/ GERALYN S. RITTER
Geralyn S. Ritter
(Attorney-in-Fact)

Exhibit 23.1

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We hereby consent to the incorporation by reference in the Registration Statements on Form S-3 (Nos. 333-185248, 333-185245, 333-164482, 333-163858 and 333-163546) and on Form S-8 (Nos. 333-173025, 333-173024, 333-162882, 333-162883, 333-162884, 333-162885, 333-162886, 033-57111, 333-112421, 333-134281, 333-121089, 333-30331, 333-87077, 333-153542, 333-162007, 333-91440 and 333-105567) of Merck & Co., Inc. of our report dated February 26, 2013 relating to the financial statements and the effectiveness of internal control over financial reporting, which appears in this Form 10-K.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

Florham Park, New Jersey
February 26, 2013

EX-21 8 d438975dex21.htm EX-21

Exhibit 21

MERCK & CO., INC. SUBSIDIARIES
as of 12/31/12

The following is a list of subsidiaries of the Company, doing business under the name stated.

Name	Country or State of Incorporation
7728026 Canada Inc.	Canada
Aacifar-Produtos Quimicos e Farmaceuticos, Lda	Portugal
Abmaxis Inc.	Delaware
Aquaculture Holdings Limited	United Kingdom
Aquaculture Vaccines Limited	United Kingdom
Ark Products Limited	United Kingdom
AVL Holdings Limited	United Kingdom
Avondale Chemical Co. Limited	Ireland
Banyu Pharmaceutical Company, Ltd.	Japan
Beneficiadora E Industrializadora, S.A. de C.V.	Mexico
Brazil Holdings Ltd.	Bermuda
BRC Ltd.	Bermuda
Burgwedel Biotech GmbH	Germany
Canji, Inc.	Delaware
Charles E. Frosst (U.K.) Limited	United Kingdom
Chemibiotic (Ireland) Limited	Ireland
Cherokee Pharmaceuticals LLC	Delaware
Chibret pharmazeutische Gesellschaft mit beschränkter Haftung	Germany
Cloverleaf International Holdings S.a.r.l.	Luxembourg
Comsort, Inc.	Delaware
Continuum Professional Services Limited	United Kingdom
Cooper Veterinary Products (Proprietary) Limited	South Africa
Coopers Animal Health Limited	United Kingdom
Coopers Sáude Animal Indústria e Comércio Ltda.	Brazil
Cosmas B.V.	Netherlands
Crosswinds B.V.	Netherlands
Dashtag	United Kingdom
Desarrollos Farmaceuticos Y Cosmeticos, S.A.	Spain
Dieckmann Arzneimittel GmbH	Germany
Diosynth Apeldoorn B.V.	Netherlands
Diosynth France	France
Diosynth Holding B.V.	Netherlands
Diosynth International B.V.	Netherlands
Diosynth Limited	United Kingdom
Diosynth Produtos Farmo-quimicos Ltda.	Brazil
Essex Asia Limited	Hong Kong
Essex Beteiligungs GmbH & Co KG	Germany
Essex Chemie AG	Switzerland
Essex Farmaceutica, S.A.	Colombia
Essex Italia s.r.l.	Italy
Essex Pharma GmbH	Germany
Essex Pharmaceuticals, Inc.	Philippines
Essexfarm, S.A.	Ecuador
European Insurance Risk Excess Limited	Ireland
Farmaas B.V.	Netherlands
Farmacox-Companhia Farmaceutica, Lda	Portugal
Farmasix-Produtos Farmaceuticos, Lda	Portugal

Financiere MSD	France
Fontelabor-Produtos Farmaceuticos, Lda.	Portugal
Frosst Laboratories, Inc.	Delaware
Frosst Portuguesa - Produtos Farmaceuticos, Lda.	Portugal
Fulford (India) Limited[1]	India
Global Animal Management, Inc.	Delaware
GlycoFi, Inc.	Delaware
Hangzhou MSD Pharmaceutical Company Limited[1]	China
Hawk and Falcon L.L.C.	Delaware
Heptafarma - Companhia Farmacêutica, Sociedade Unipessoal, Lda.	Portugal
Horus B.V.	Netherlands
Hydrochemie GmbH	Germany
Inspire Pharmaceuticals, Inc.	Delaware
International Indemnity Ltd.	Bermuda
Intervet	France
Intervet (Hong Kong) Ltd	Hong Kong
Intervet (Ireland) Limited	Ireland
Intervet (Israel) Ltd.	Israel
Intervet (M) Sdn. Bhd.	Malaysia
Intervet (Proprietary) Ltd	South Africa
Intervet (Thailand) Ltd.	Thailand
Intervet AB	Sweden
Intervet Agencies B.V.	Netherlands
Intervet Animal Health Taiwan Limited	Taiwan (Republic of China)
Intervet Argentina S.A.	Argentina
Intervet Australia Pty Limited	Australia
Intervet Bulgaria EOOD	Bulgaria
Intervet Canada Corp.	Canada
Intervet Central America S. de R.L.	Panama
Intervet Colombia Ltda	Colombia
Intervet Danmark A/S	Denmark
Intervet Deutschland GmbH	Germany
Intervet do Brasil Veterinaria Ltda	Brazil
Intervet Ecuador S.A.	Ecuador
Intervet Egypt for Animal Health SAE	Egypt
Intervet GesmbH	Austria
Intervet Hellas A.E.	Greece
Intervet Holding B.V.	Netherlands
Intervet Holding Costa Rica SA	Costa Rica
Intervet Holding Iberia, S.L.	Spain
Intervet Holdings France	France
Intervet Hungaria Kft	Hungary
Intervet Inc.	Delaware
Intervet India Pvt. Ltd	India
Intervet International	France
Intervet International B.V.	Netherlands
Intervet International GmbH	Germany
Intervet Italia S.r.l.	Italy
Intervet K.K.	Japan
Intervet Korea Ltd.	Korea, Republic of
Intervet LLC	Russian Federation
Intervet Maroc	Morocco
Intervet Mexico S.A. de C.V.	Mexico
Intervet Middle East Ltd	Cyprus

Intervet Nederland B.V.	Netherlands
Intervet Norge AS	Norway
Intervet Oy	Finland
Intervet Philippines, Inc.	Philippines
Intervet Productions	France
Intervet Productions Srl	Italy
Intervet Romania SRL	Romania
Intervet Rural Co Pty. Ltd.	Australia
Intervet S.A.	Peru
Intervet Schering-Plough Animal Health Pty Ltd	Australia
Intervet South Africa (Proprietary) Limited	South Africa
Intervet Sp. z o.o.	Poland
Intervet UK Limited	United Kingdom
Intervet UK Production Limited	United Kingdom
Intervet Venezolana SA	Venezuela
Intervet Veterinaria Chile Ltda	Chile
Intervet Veteriner Ilaclari Pazarlama ve Ticaret Ltd. Sirketi	Turkey
Intervet Vietnam Ltd.	Viet Nam
Intervet, s.r.o.	Czech Republic
Interveterinaria SA de CV	Mexico
KBI Inc.	Delaware
KBI Sub Inc.	Delaware
KBI-E Inc.	Delaware
KBI-P Inc.	Delaware
Kirby-Warrick Pharmaceuticals Limited	United Kingdom
Laboratoires Merck Sharp & Dohme-Chibret	France
Laboratorios Abello, S.A.	Spain
Laboratorios Biopat, S.A.	Spain
Laboratorios Chibret, S.A.	Spain
Laboratorios Essex S.A.	Argentina
Laboratorios Frosst, S.A.	Spain
Laboratorios Organon S.A. de C.V.	Mexico
Laboratorios Quimico-Farmaceuticos Chibret, Lda.	Portugal
Livestock Nutrition Technologies Pty. Ltd.	Australia
Loftus Bryan Chemicals Limited	Ireland
LOSPAR Partnership[1]	Delaware
Maple Leaf Holdings GmbH	Switzerland
Maya Tibbi Limited Sirketi	Turkey
MCM Vaccine Co.[1]	Pennsylvania
Med-Nim (Proprietary) Limited	South Africa
Merck and Company, Incorporated	Delaware
Merck Canada Inc.	Canada
Merck Capital Ventures, LLC[1]	Delaware
Merck Frosst Canada & Co.	Canada
Merck Frosst Company	Canada
Merck Frosst Finco LP	Canada
Merck Global Health Innovation Fund, LLC	Delaware
Merck HDAC Research, LLC	Delaware
Merck Holdings II Corp.	Delaware
Merck Holdings LLC	Delaware
Merck Lumira Biosciences Fund L.P.	Canada
Merck Registry Holdings, Inc.	New Jersey
Merck Respiratory Health Company	Nevada
Merck Retail Ventures, Inc.	Delaware

Merck SH Inc.	Delaware
Merck Sharp & Dohme (Argentina) Inc.	Delaware
Merck Sharp & Dohme (Asia) Limited	Hong Kong
Merck Sharp & Dohme (Australia) Pty. Limited	Australia
Merck Sharp & Dohme (Chile) Ltda.	Chile
Merck Sharp & Dohme (China) Limited	Hong Kong
Merck Sharp & Dohme (Enterprises) B.V.	Netherlands
Merck Sharp & Dohme (Europe) Inc.	Delaware
Merck Sharp & Dohme (Holdings) B.V.	Netherlands
Merck Sharp & Dohme (Holdings) Limited	United Kingdom
Merck Sharp & Dohme (Holdings) Pty Ltd	Australia
Merck Sharp & Dohme (I.A.) Corp.	Delaware
Merck Sharp & Dohme (International) Limited	Bermuda
Merck Sharp & Dohme (Israel - 1996) Company Ltd.	Israel
Merck Sharp & Dohme (Italia) S.p.A.	Italy
Merck Sharp & Dohme (Malaysia) SDN. BHD.	Malaysia
Merck Sharp & Dohme (New Zealand) Limited	New Zealand
Merck Sharp & Dohme (Sweden) A.B.	Sweden
Merck Sharp & Dohme (Switzerland) GmbH	Switzerland
Merck Sharp & Dohme Animal Health, S.L.	Spain
Merck Sharp & Dohme Asia Pacific Services Pte. Ltd.	Singapore
Merck Sharp & Dohme B.V.	Netherlands
Merck Sharp & Dohme BH d.o.o.	Bosnia
Merck Sharp & Dohme Bulgaria EOOD	Bulgaria
Merck Sharp & Dohme Colombia S.A.S.	Colombia
Merck Sharp & Dohme Comercializadora, S. de R.L. de C.V.	Mexico
Merck Sharp & Dohme Corp.	New Jersey ✓
Merck Sharp & Dohme Cyprus Limited	Cyprus
Merck Sharp & Dohme d.o.o.	Croatia
Merck Sharp & Dohme d.o.o. Belgrade	Serbia
Merck Sharp & Dohme de Espana SAU	Spain
Merck Sharp & Dohme de Mexico S.A. de C.V.	Mexico
Merck Sharp & Dohme de Puerto Rico, Inc.	Delaware
Merck Sharp & Dohme Farmaceutica Ltda.	Brazil
Merck Sharp & Dohme Finance Europe Limited	United Kingdom
Merck Sharp & Dohme Gesellschaft m.b.H.	Austria
Merck Sharp & Dohme IDEA AG	Switzerland
Merck Sharp & Dohme inovativna zdravila d.o.o.	Slovenia
Merck Sharp & Dohme International Services B.V.	Netherlands
Merck Sharp & Dohme Ireland (Human Health) Ltd	Ireland
Merck Sharp & Dohme Limited	United Kingdom
Merck Sharp & Dohme Manufacturing	Ireland
Merck Sharp & Dohme Manufacturing Holdings	Bermuda
Merck Sharp & Dohme OU	Estonia
Merck Sharp & Dohme Peru SRL	Peru
Merck Sharp & Dohme Pharmaceutical Industrial and Commercial Societe Anonyme	Greece
Merck Sharp & Dohme Pharmaceuticals LLC	Russia
Merck Sharp & Dohme Quimica de Puerto Rico, Inc.	Delaware
Merck Sharp & Dohme Research GmbH	Switzerland
Merck Sharp & Dohme Romania SRL	Romania

Merck Sharp & Dohme S.A.	Morocco
Merck Sharp & Dohme s.r.o.	Czech Republic
Merck Sharp & Dohme SIA	Latvia
Merck Sharp & Dohme Singapore Trading Pte. Ltd.	Singapore
Merck Sharp & Dohme Tunisie SARL	Tunisia
Merck Sharp & Dohme, Limitada	Portugal
Merck Sharp & Dohme, S. de R.L. de C.V.	Mexico
Merck Sharp & Dohme, s.r.o.	Slovakia
Merck Sharp Dohme Ilaclari Limited Sirketi	Turkey
ML Holdings (Canada) Inc.	Canada
MSD (Italia) s.r.l.	Italy
MSD (L-SP) Unterstützungskasse GmbH	Germany
MSD (Nippon Holdings) BV	Netherlands
MSD (Norge) AS	Norway
MSD (Proprietary) Limited	South Africa
MSD (Shanghai) Pharmaceuticals Consultancy Co., Ltd.	China
MSD (Thailand) Ltd.	Thailand
MSD Animal Health BVBA	Belgium
MSD Animal Health GmbH	Switzerland
MSD Animal Health Innovation AS	Norway
MSD Animal Health Innovation GmbH	Germany
MSD Animal Health Innovation Pte. Ltd.	Singapore
MSD Animal Health Innovation SAS	France
MSD Animal Health Limited	United Kingdom
MSD Animal Health, Lda.	Portugal
MSD Argentina Holdings B.V.	Netherlands
MSD Asia Holdings Pte. Ltd.	Singapore
MSD Belgium BVBA/SPRL	Belgium
MSD Beteiligungs GmbH & Co KG	Germany
MSD BM 1 Ltd.	Bermuda
MSD BM 2 Ltd.	Bermuda
MSD Brazil (Investments) B.V.	Netherlands
MSD Central America Services S. de R.L.	Panama
MSD Chibropharm GmbH	Germany
MSD China (Investments) B.V.	Netherlands
MSD China B.V.	Netherlands
MSD China Holding Co., Ltd.	China
MSD Consumer Care Limited	United Kingdom
MSD Consumer Care, Inc.	Delaware
MSD Danmark ApS	Denmark
MSD Egypt LLC	Egypt
MSD EIC	Ireland
MSD Eurofinance	Bermuda
MSD Farmaceutica C.A.	Venezuela
MSD Finance 2 LLC	Delaware
MSD Finance B.V.	Netherlands
MSD Finance Company	Bermuda
MSD Finance Holding NL B.V.	Netherlands
MSD Finance Holdings	Ireland
MSD Finland Oy	Finland
MSD France	France

MSD Holdings G.K.	Japan
MSD Hong Kong Holdings Cooperatief U.A.	Netherlands
MSD Human Health Holding BV	Netherlands
MSD IDEA Pharmaceuticals Nigeria Limited	Nigeria
MSD International Finance LLC	Delaware
MSD International GmbH	Switzerland
MSD International Holdings GmbH	Switzerland
MSD International Holdings, Inc.	Delaware
MSD International Ventures B.V.	Netherlands
MSD Investment Holdings (Ireland)	Ireland
MSD Investments (Holdings) GmbH	Switzerland
MSD K.K.	Japan
MSD Korea Ltd.	Korea
MSD Laboratories India LLC	Delaware
MSD Latin America Services S. de R.L.	Panama
MSD Latin America Services S. de R.L. de C.V.	Mexico
MSD Limited	United Kingdom
MSD Luxembourg S.a.r.l.	Luxembourg
MSD Magyarország Kereskedelmi es Szolgaltato Kft	Hungary
MSD Merck Sharp & Dohme A.G.	Switzerland
MSD Mexico Investments B.V.	Netherlands
MSD Netherlands (Holding) B.V.	Netherlands
MSD NL 2 B.V.	Netherlands
MSD NL 4 B.V.	Netherlands
MSD Oss B.V.	Netherlands
MSD Overseas Manufacturing Co (Ireland)	Ireland
MSD Panama International Services S. de R.L.	Panama
MSD Participations B.V.	Netherlands
MSD Pharma (Singapore) Pte. Ltd.	Singapore
MSD Pharma Hungary Korlatolt Felelossegu Tarsasag	Hungary
MSD Pharmaceuticals Holdings	Ireland
MSD Pharmaceuticals Investments 1	Ireland
MSD Pharmaceuticals Investments 2	Ireland
MSD Pharmaceuticals Investments 3	Ireland
MSD Pharmaceuticals Ireland	Ireland
MSD Pharmaceuticals LLC	Russian Federation
MSD Pharmaceuticals Private Limited	India
MSD Polska Sp.z.o.o.	Poland
MSD R&D (China) Co., Ltd.	China
MSD Regional Business Support Center GmbH	Germany
MSD Registry Holdings, Inc.	New Jersey
MSD Shared Business Services EMEA Limited	Ireland
MSD Sharp & Dohme Gesellschaft mit beschränkter Haftung	Germany
MSD Stamford Singapore Pte Ltd	Singapore
MSD Supply Services Inc.	Puerto Rico
MSD Switzerland Investments 1	Ireland
MSD Switzerland Investments 2	Ireland
MSD Switzerland Investments 3	Ireland
MSD Switzerland Investments 4	Ireland
MSD Technology Singapore Pte. Ltd.	Singapore
MSD Tuas Singapore Pte. Ltd.	Singapore

MSD Ukraine Limited Liability Company	Ukraine
MSD Unterstutzungskasse GmbH	Germany
MSD Venezuela Holding GmbH	Switzerland
MSD Ventures (Ireland)	Ireland
MSD Ventures Singapore Pte. Ltd.	Singapore
MSD Verwaltungs GmbH	Germany
MSD Vietnam Holdings B.V.	Netherlands
MSD Vostok B.V.	Netherlands
MSD-SP Ltd.	United Kingdom
MSD-Sun FZ-LLC	United Arab Emirates
MSD-SUN, LLC[1]	Delaware
MSP Singapore Company, LLC	Delaware
Multilan AG	Switzerland
Mycofarm International B.V.	Netherlands
Mycofarm Nederland B.V.	Netherlands
Mycofarm UK Limited	United Kingdom
N.V. Organon	Netherlands
Nanjing Organon Pharmaceutical Co., Ltd.	China
Nourifarma - Produtos Quimicos e Farmaceuticos Lda	Portugal
Nourypharma Nederland B.V.	Netherlands
NovaCardia, Inc.	Delaware
OBS Holdings B.V.	Netherlands
Orgachemia B.V.	Netherlands
Orgachemica Nigeria Ltd[1]	Nigeria
Organon (Hong Kong) Ltd	Hong Kong
Organon (India) Pvt. Ltd.[1]	India
Organon (Ireland) Ltd	Ireland
Organon (Malaysia) Sdn. Bhd.	Malaysia
Organon (Philippines) Inc.	Philippines
Organon A/O	Russian Federation
Organon Agencies B.V.	Netherlands
Organon API Inc.	Delaware
Organon Asia Pacific Sdn.Bhd.	Malaysia
Organon BioSciences International B.V.	Netherlands
Organon BioSciences Nederland B.V.	Netherlands
Organon BioSciences Reinsurance Limited	Ireland
Organon BioSciences Ventures B.V.	Netherlands
Organon China B.V.	Netherlands
Organon Dominicana SA	Dominican Republic
Organon Egypt Ltd	Egypt
Organon GmbH	Germany
Organon International B.V.	Netherlands
Organon Laboratories Limited	United Kingdom
Organon Latin America S.A.	Uruguay
Organon Middle East Ltd. Cyprus	Cyprus
Organon Middle East S.A.L. (Lebanon)	Lebanon
Organon Participations B.V.	Netherlands
Organon Slovakia spol. s.r.o.	Slovakia
Organon Teknika Corporation LLC	Delaware
Organon Teknika Holding B.V.	Netherlands
Organon USA Inc.	New Jersey
P.T. Merck Sharp & Dohme Indonesia	Indonesia

Pasteur Vaccins S.A. [1]	France
Pharmaco Canada Inc.	Canada
Pitman-Moore Saude Animal Comercio e Distribuicao de Produtos Veterinarios	Brazil
Plough (U.K.) Limited	United Kingdom
Plough Consumer Products (Asia) Ltd.	Hong Kong
Plough Farma, Lda.	Portugal
Protein Transaction, LLC	Delaware
PT Intervet Indonesia	Indonesia
PT Organon Indonesia	Indonesia
PT Schering-Plough Indonesia Tbk. [1]	Indonesia
Rosetta Biosoftware UK Limited	United Kingdom
Rosetta Inpharmatics LLC	Delaware
Sanofi Pasteur MSD A/S[1]	Denmark
Sanofi Pasteur MSD AB[1]	Sweden
Sanofi Pasteur MSD AG[1]	Switzerland
Sanofi Pasteur MSD ApS[1]	Denmark
Sanofi Pasteur MSD AS[1]	Norway
Sanofi Pasteur MSD Gestion S.A.[1]	France
Sanofi Pasteur MSD GmbH[1]	Austria
Sanofi Pasteur MSD GmbH[1]	Germany
Sanofi Pasteur MSD Ltd. [1]	Ireland
Sanofi Pasteur MSD Limited [1]	United Kingdom
Sanofi Pasteur MSD N.V./S.A. [1]	Belgium
Sanofi Pasteur MSD Oy[1]	Finland
Sanofi Pasteur MSD S.A. [1]	Portugal
Sanofi Pasteur MSD S.A. [1]	Spain
Sanofi Pasteur MSD S.p.A. [1]	Italy
Sanofi Pasteur MSD SNC [1]	France
Schering Holdings Mexico, S. de R.L. de C.V.	Mexico
Schering-Plough	France
Schering-Plough (Bray)	Ireland
Schering-Plough (China) Limited	Bermuda
Schering-Plough (India) Private Limited	India
Schering-Plough (Ireland) Company	Ireland
Schering-Plough (Proprietary) Limited	South Africa
Schering-Plough (Shanghai) Trading Company, Ltd.	China
Schering-Plough (Singapore) Pte. Ltd.	Singapore
Schering-Plough (Singapore) Research Pte. Ltd.	Singapore
Schering-Plough Animal Health Limited	Ireland
Schering-Plough Animal Health Limited	New Zealand
Schering-Plough Animal Health Operations Sdn. Bhd.	Malaysia
Schering-Plough Animal Health, Inc.	Philippines
Schering-Plough Bermuda Ltd.	Bermuda
Schering-Plough Canada Inc.	Canada
Schering-Plough Central East AG	Switzerland
Schering-Plough Clinical Trials, S.E.	United Kingdom
Schering-Plough Corporation	Philippines
Schering-Plough Corporation, U.S.A.	Delaware
Schering-Plough del Caribe, Inc.	New Jersey
Schering-Plough del Ecuador, S.A.	Ecuador
Schering-Plough del Peru S.A.	Peru
Schering-Plough Holdings (Ireland) Company	Ireland
Schering-Plough Holdings Limited	United Kingdom

Schering-Plough Indústria Farmacêutica Ltda.	Brazil
Schering-Plough Int Limited	United Kingdom
Schering-Plough International C.V.	Netherlands
Schering-Plough International Finance Company B.V.	Netherlands
Schering-Plough International LLC	Delaware
Schering-Plough Investments Cayman Ltd.	Cayman Islands
Schering-Plough Investments Ltd.	Delaware
Schering-Plough Israel AG	Switzerland
Schering-Plough Labo NV	Belgium
Schering-Plough Limited	Taiwan (Republic of China)
Schering-Plough Limited	United Kingdom
Schering-Plough Limited C.V.	Netherlands
Schering-Plough Luxembourg S.a.r.L.	Luxembourg
Schering-Plough Pensions Ireland Limited	Ireland
Schering-Plough Pharmaceuticals (Ireland) Limited	Ireland
Schering-Plough Products, L.L.C.	Delaware
Schering-Plough S.A.	Panama
Schering-Plough S.A.	Paraguay
Schering-Plough S.A.	Spain
Schering-Plough S.A.	Uruguay
Schering-Plough S.A. de C.V.	Mexico
Schering-Plough S.A.[1]	Argentina
Schering-Plough s.r.l.	Italy
Schering-Plough Sante Animale	France
Schering-Plough Technologies Pte. Ltd.	Singapore
Sentipharm AG	Switzerland
Servicios Veterniarios Servet, Sociedad Anónima	Costa Rica
Shanghai MSD Pharmaceutical Trading Co., Ltd.	China
Shanghai Schering-Plough Pharmaceutical Company, Ltd.	China
Simcere MSD (Shanghai) Pharmaceuticals Co. Ltd.[1]	China
Sinova AG[1]	Switzerland
Sirna Therapeutics, Inc.	Delaware
SmartCells, Inc.	Delaware
SOL Limited	Bermuda
S-P Bermuda	Bermuda
SP Maroc S.a.R.L.	Morocco
S-P Ril Ltd.	United Kingdom
S-P Veterinary (UK) Limited	United Kingdom
S-P Veterinary Holdings Limited	United Kingdom
S-P Veterinary Limited	United Kingdom
S-P Veterinary Pensions Limited	United Kingdom
Supera Rx Medicamentos Ltda.[1]	Brazil
Tasman Vaccine Laboratory (UK) Ltd	United Kingdom
TELERx Marketing Inc.	Pennsylvania
The Coppertone Corporation	Florida
The MSD Foundation Limited	United Kingdom
Theriak B.V.	Netherlands
Thomas Morson & Son Limited	United Kingdom
Transrow Manufacturing Ltd.	Bermuda
UAB Merck Sharp & Dohme	Lithuania
Undra, S.A. de C.V.	Mexico
VARIPHARM Arzneimittel GmbH	Germany
Venco Farmaceutica C.A.	Venezuela
Venco Holding GmbH	Switzerland

Vet Pharma Friesoythe GmbH	Germany
VetInvent, LLC	Delaware
Vetrex B.V.	Netherlands
Vetrex Egypt L.L.C.	Egypt
Vetrex Limited	United Kingdom
Vree Health Italia S.r.l.	Italy
Vree Health LLC	Delaware
Werthenstein Biopharma GmbH	Switzerland
Zoöpharm B.V.	Netherlands

[1] own less than 100%

AMENDED AND RESTATED

CERTIFICATE OF INCORPORATION

OF

SCHERING CORPORATION

(EIN Number: 22-1261880)

Schering Corporation (the "Corporation"), a corporation organized and existing under the laws of the State of New Jersey, does hereby certify that:

1. The original Certificate of Incorporation was filed with the Secretary of State of the State of New Jersey on December 19, 1935 and the name under which it was originally incorporated is Schering Corporation.

2. This Amended and Restated Certificate of Incorporation was duly adopted in accordance with Sections 14A:9-1 and 14A:9-5 of the New Jersey Business Corporation Act (the "NJBCA"), and has been duly approved by the written consent of the Board of Directors of the Corporation in accordance with Section 14A:9-2 of the NJBCA, and restates, integrates and further amends the provisions of the Corporation's Restated Certificate of Incorporation.

3. The text of the original Certificate of Incorporation and any amendment and restatement thereto is hereby amended and restated to read in its entirety as follows:

FIRST: The name of the corporation is: MERCK SHARP & DOHME CORP.

SECOND: The purpose or purposes for which the corporation is organized includes any activity within the purposes for which corporations may be organized under the NJBCA, including, but not limited to:

(a) To buy, sell, import, export, deal in, at wholesale and/or retail, as principals, agents, factors, or otherwise, and/or to manufacture, develop, produce and prepare any and all kinds of chemicals, drugs, alkalis, salts, compounds, medicinal, and proprietary preparations, supplies and articles, and also all materials, ingredients, substances, articles, apparatus and appliances used in or pertinent to the manufacture, production and preparation thereof;

(b) To carry on and undertake any other similar business which may from time to time seem to the directors of this corporation capable of being conveniently carried on in connection with the above purposes or calculated directly or indirectly to render valuable or enhance the value of any of the corporation's privileges or rights;

(c) The corporation is expressly authorized to conduct its business in all its branches at one or more offices, to carry on any one or more of the purposes herein set forth, in the State of New Jersey and in any other states and territories and dependencies of the Unite States and in foreign countries.

In furtherance and not in limitation of the general powers conferred by the laws of the State of New Jersey and of the objects and purposes hereinbefore stated, it is hereby expressly provided that the corporation shall have also the following powers and purposes:

(d) To purchase, lease, exchange or otherwise acquire; to hold, own, use, operate, lease; to sell, transfer, assign, convey, mortgage, pledge or otherwise dispose of or encumber such real and personal property of every description and wherever situated as may be necessary or convenient for the business of this corporation without limit as to amount;

(e) To borrow money, make, issue and sell, pledge or otherwise dispose of bonds, debentures and other evidences of indebtedness of all kinds, whether secured by mortgage or otherwise and without limit as to amount and also to secure the same by mortgage, pledge or otherwise;

(f) To purchase, subscribe to, acquire, hold and dispose of stocks, bonds and other evidences of indebtedness of any corporation, domestic or foreign, or of any individual, firm or association, or of any domestic or foreign state, government, municipality, or governmental authority, and to issue in exchange therefore the stocks, bonds or other obligations of this corporation and while the owner thereof, to exercise all rights, powers and privileges of ownership, including any and all voting power thereon;

(g) To acquire and take over as a going concern and to carry on the business of any person, firm, association or corporation engaged in any business which this corporation is authorized to carry on and in connection therewith, to acquire the goodwill and all or any part of the property and assets of all kinds and to assume or otherwise provide for all or any part of the liabilities of the owner or owners of such business and to pay for the same in cash or with the stocks, bonds, debentures or other securities or obligations of this corporation or otherwise;

(h) To enter into, make, purchase, acquire by assignment or otherwise and to carry out and perform contracts of every sort and kind which may be necessary or convenient for the business of this corporation with any person, firm, corporation, private, public or municipal body politic under the

Government of the United States or of any state, territory or colony thereof, or of any foreign government;

(i) To lend money to any corporation, partnership, association or person upon the security of its, their or his undertaking, property, estate, assets and effects, or any part thereof, upon such terms as the Board of Directors may deem expedient; to guarantee the payment of principal or dividends or interest of or on any shares, stocks, or debentures, and to guarantee or assume any bonds or notes or other securities or any other contract or obligation issued or executed or incurred by any corporation, firm or individual whenever desirable in the judgment of the Board of Directors and to use its name and credit for the benefit of other corporations, firms or individuals as may to the Board of Directors seem advisable, but nothing herein shall be construed to authorize loans forbidden by Section 48 of the General Corporations Act of New Jersey;

(j) To cause or allow the legal title, estate and interest in any property, acquired, established or carried on by the corporation, to remain or be vested, or registered in the name of, or carried on by, any person, firm or corporation, foreign or domestic, formed or to be formed, and either upon trust for, or as agents or nominees of this corporation, or upon any other terms or conditions which the Board of Directors may consider for the benefit of this corporation, and to manage the affairs or take over and carry on the business of such person, firm or corporation, foreign or domestic, formed, or to be formed, either by acquiring the shares, stocks, or other securities thereof, or otherwise howsoever, and to exercise all or any of the powers of holders of shares, stocks or securities thereof, and to receive and distribute as profits the dividends and interests on such shares, stocks or securities;

(k) To build, construct, erect, purchase, hire or otherwise acquire or provide and to maintain, operate and alter any buildings, factories, workshops, laboratories, offices, machinery and equipment, or other things necessary or useful for carrying out the objects of the corporation;

(l) To act as agents for others in any business or for any purpose and upon any terms, and whether with our without remuneration;

(m) To enter into any arrangement for sharing profits, union of interest, reciprocal concession, or cooperation with any person or corporation carrying on or about to carry on any business which this corporation is authorized to carry on, or any business or transaction capable of being conducted so as to benefit the corporation, directly or indirectly, and to take or otherwise acquire and hold shares of stock in, or securities of, any corporation, and to subsidize or otherwise assist any such person or corporation, and to sell, hold, reissue with or without guarantee, or otherwise deal with such shares or securities;

(n) To invest and deal with the moneys of the corporation not immediately required in its business in such securities and in such manner as may from time to time be determined, and as may be permitted by law to a corporation;

(o) To apply for, purchase or otherwise acquire any patents, brevets, d'invention, licenses, concessions and the like conferring any exclusive or non-exclusive or limited right to use any invention which may seem capable of being used for any of the purposes of the corporation, or the acquisition of which may seem calculated directly or indirectly to benefit this corporation, and to use, exercise, develop or grant licenses in respect of, or otherwise turn to account the property and rights so acquired;

(p) The corporation shall have power to do any and all things set forth as the objects for which it is formed. To the same extent and as fully as a natural person might or could do, in any part of the world, as principal, agent, director or otherwise, and to carry out all or any of the foregoing objects as principals, agents, contractors or otherwise, and by and through trustees, agents, subcontractors or otherwise, and alone or jointly with other corporation, association, firm or person, and in any part of the world.

Nothing in this certificate is to be construed as intended to form a banking corporation, a trust company, a savings bank or a surety or insurance company, or to give to this corporation any of the powers lawfully possessed by such corporations exclusively.

THIRD: The aggregate number of shares which the corporation shall have authority to issue is 1,000,000 common shares of the par value of one Dollar ($1) each, amounting in the aggregate to one million Dollars ($1,000,000).

FOURTH: The address of the Corporation's principal office is at One Merck Drive, Whitehouse Station, New Jersey 08889. The address of the Corporation's registered office in the State of New Jersey is 820 Bear Tavern Road, West Trenton, New Jersey, 08628 and the name of the Corporation's registered agent at such address is The Corporation Trust Company.

FIFTH: The number of directors constituting the board is three, and the name and address of the persons who are to serve as such directors are: John Canan, One Merck Drive, Whitehouse Station, New Jersey, 08889; Celia A. Colbert, One Merck Drive, Whitehouse Station, New Jersey, 08889; and Mark E. McDonough, One Merck Drive, Whitehouse Station, New Jersey, 08889.

SIXTH: To the fullest extent permitted by the laws of the State of New Jersey, as they exist or may hereafter be amended, all current and former directors and officers of the Corporation shall not be personally liable to the Corporation or its stockholders for damages for breach of any duty owed to the Corporation or its stockholders, except that the provisions of this paragraph shall not relieve a director or officer from liability for any breach of duty based upon an act or omission (a) in breach of such person's duty of loyalty to the Corporation or its stockholders, (b) not in good faith or involving a knowing violation of law or (c) resulting in receipt by such person of an improper personal benefit.

SEVENTH: The Corporation reserves the right to amend, alter, change or repeal any provision contained in this Certificate of Incorporation in the manner now or hereafter prescribed by statute and all rights conferred on the stockholders hereunder are granted subject to this reservation.

This Amended and Restated Certificate of Incorporation shall be effective 3:01 AM Eastern Daylight Time, May 1, 2012.

IN WITNESS WHEREOF, the undersigned has executed this Amended and Restated Certificate of Incorporation this 26th day of April, 2012.

Katie Fedosz

Katie Fedosz
Assistant Secretary

FILED
NOV 02 2009
STATE TREASURER

CERTIFICATE OF ADOPTION
OF
RESTATED CERTIFICATE OF INCORPORATION
OF
SCHERING-PLOUGH CORPORATION
(ID Number: 7954610000)

Schering-Plough Corporation, a corporation organized and existing under the laws of the State of New Jersey (the "Corporation"), to amend and restate its Certificate of Incorporation pursuant to Section 14A:9-5 of the New Jersey Business Corporation Act (the "NJBCA"), hereby certifies as follows:

FIRST: The name of the Corporation is Merck & Co., Inc.

SECOND: The Restated Certificate of Incorporation attached hereto (the "Restated Certificate") was adopted by the shareholders of the Corporation on August 7, 2009 as part of their approval of the Agreement and Plan of Merger, dated as of March 8, 2009, by and among Merck & Co., Inc., the Corporation, SP Merger Subsidiary One, Inc. (formerly known as Blue, Inc.), and SP Merger Subsidiary Two, Inc. (formerly known as Purple, Inc.), and pursuant to Section 14A:10-1 and Section 14A:10-5.1 of the NJBCA.

THIRD: The number of shares entitled to vote on the adoption of the Restated Certificate was 1,633,437,974 shares of Common Stock, of which 1,269,837,983 voted for the Restated Certificate as part of their approval of the Agreement and Plan of Merger, and 11,910,123 voted against the Restated Certificate. No shares of any class or series were entitled to vote thereon as a class.

FOURTH: This Certificate of Adoption shall become effective on November 3, 2009 at 4:01 p.m.

IN WITNESS WHEREOF, the Corporation has caused this Certificate to be duly executed as of the 2nd day of November, 2009.

SCHERING-PLOUGH CORPORATION

By: [signature]

Name: Susan Ellen Wolf

Title: Corporate Secretary, Vice President, Corporate Governance and Associate General Counsel

RESTATED CERTIFICATE OF INCORPORATION

of

SCHERING-PLOUGH CORPORATION
(ID Number: 7954610000)

Schering-Plough Corporation, a corporation organized and existing under the laws of the State of New Jersey (the "Corporation "), restates and integrates its Restated Certificate of Incorporation, as heretofore amended and also substantively amends such Restated Certificate of Incorporation, to read in full as herein set forth:

ARTICLE I: NAME

The name of the Corporation shall be Merck & Co., Inc.

ARTICLE II: REGISTERED OFFICE AND AGENT

The address of the Corporation's current registered office is 2000 Galloping Hill Road, Kenilworth, New Jersey 07033 and the name of its current registered agent thereat is Susan Ellen Wolf. Upon the filing of this Restated Certificate of Incorporation, the address of the Corporation's registered office shall be 820 Bear Tavern Road, City of West Trenton, County of Mercer, State of New Jersey, 08628, and the name of its registered agent thereat shall be The Corporation Trust Company.

ARTICLE III: OBJECTS AND PURPOSES

The objects and purposes of the Corporation shall be:

To carry on the business of exercising, performing, developing, manufacturing, producing, obtaining, promoting, selling and distributing rights, services, goods, wares, and merchandise of all kinds, including but not by way of limitation, those in the chemical, mineral, pharmaceutical, biological, medicinal, agricultural, mechanical and electrical fields;

To carry on such business alone, in, with or as agent for other individuals, partnerships, joint ventures, corporations, syndicates or other forms of enterprise;

To borrow or lend money and to make guarantees insofar as such powers may now or hereafter be lawfully exercised by a corporation subject to Title 14A of the New Jersey statutes; and

To engage in any other activity within the purposes for which corporations may be organized under the New Jersey Business Corporation Act.

The enumeration herein of the objects and purposes of the Corporation shall be construed as powers as well as objects and purposes and shall not be deemed to exclude by inference any powers, objects or purposes which any corporation subject to Title 14A of the New Jersey statutes may now or hereafter be empowered to exercise.

ARTICLE IV: CAPITAL STOCK

The amount of the total authorized capital stock of the Corporation shall be 6,520,000,000 shares, consisting of (i) 6,500,000,000 shares of Common Stock, par value $0.50 per share, and (ii) 20,000,000 shares of Preferred Stock, par value $1.00 per share, issuable in one or more series.

The Board of Directors may from time to time offer for subscription or otherwise issue or sell any or all of the unissued stock of any class, or any shares of stock of any class which may be held in the treasury of the Corporation, to such persons, firms or corporations and for such consideration (so far as may be permitted by the laws of the State of New Jersey) as it shall from time to time in its absolute discretion determine. No holder of capital stock shall have any pre-emptive right as such holder to subscribe for, purchase or receive any part of any new or additional issue of stock of any class, including unissued and treasury stock, or obligations or other securities convertible into or exchangeable for stock of any class, or warrants or other instruments evidencing rights or options to subscribe for, purchase or receive any stock of any class, whether now or hereafter authorized and whether issued for cash or other consideration or by way of dividend.

The preferences, qualifications, limitations, voting and other rights and restrictions with respect to the capital stock of the Corporation shall be as follows (headings are for convenience only and are not to be taken as aids to interpretation):

(A) Preferred Stock

1. The Board of Directors of the Corporation is hereby expressly granted authority, subject to the provisions of this Restated Certificate of Incorporation, to authorize in accordance with New Jersey law from time to time the issue of one of more series of Preferred Stock and with respect to any such series to fix the numbers, designations, rights, preferences and limitations of such series, including, but without limiting the generality of the foregoing, series of Preferred Stock:

(a) entitling the holders thereof to cumulative, non-cumulative or partial cumulative dividends, or to no dividends;

(b) entitling the holders thereof to receive dividends payable on a parity with, or in preference to, the dividends payable on any other class or series of capital stock of the Corporation;

(c) entitling the holders thereof to preferential rights upon the liquidation of, or upon any distribution of the assets of, the Corporation;

(d) convertible, at the option of the holder or of the Corporation or both, into shares of any other class or classes of capital stock of the Corporation or of any series of the same or any other class or classes;

(e) redeemable, in whole or in part, at the option of the Corporation, in cash, bonds or other property, at such price or prices, within such period or periods, and under such conditions as the Board of Directors shall so provide, including provision for the creation of a sinking fund for the redemption thereof; and

(f) lacking voting rights or having limited voting rights or enjoying special or multiple voting rights; provided, however, that no Preferred Stock that is convertible into shares of Common Stock shall have voting rights entitling a holder of a share of Preferred Stock to a greater number of votes than those applicable to the number of Common Shares into which such share of Preferred Stock is convertible, at the initial conversion rate set for such Preferred Stock at the time of issuance thereof.

The Board of Directors may change the designation, rights, preferences, limitations, description and terms of, and number of shares in, any series as to which no shares have theretofore been issued.

All shares of any one series shall be identical in all respects with all the other shares of such series, except that shares of any one series issued at different times may differ as to the dates from which dividends thereon shall be cumulative.

2. Shares of any series of Preferred Stock which have been redeemed (whether through the operation of a sinking fund or otherwise) or purchased by the Corporation, or which, if convertible, have been converted into shares of the Corporation of any other class or classes, shall have the status of authorized and unissued shares of Preferred Stock which are not classified into any series.

3. A series of Preferred Stock has been designated the "6.00% Mandatory Convertible Preferred Stock" with such series consisting of the number of shares, with such designations, voting powers, preferences, rights, qualifications, limitations and restrictions as are stated in Annex A attached hereto and incorporated herein by reference, as adjusted in accordance with the terms of such Annex A to reflect the merger of Blue Inc. with and into the Corporation pursuant to the terms of the Agreement and Plan of Merger, dated March 8, 2009.

(B) Common Stock

Subject to the preferences, qualifications, limitations, voting and other rights and restrictions with respect to each class of the capital stock of the Corporation having any preference or priority over the Common Stock, the holders of the Common Stock shall have and possess all rights appertaining to capital stock of the Corporation.

With respect to each matter submitted to a vote of the stockholders, each holder of Common Stock shall be entitled to one vote for each share of Common Stock standing in such holder's name on the books of the Corporation. There shall be no cumulative voting. At each election of directors, a nominee for election as a director shall be elected to the Board of Directors if the number of votes cast for such nominee's election exceeds the number of votes cast against such nominee's election; provided that, if at any election of directors, the number of nominees for election as directors exceeds the number of directors to be elected, directors shall be elected by a plurality of the votes cast at such election of directors.

Any of the following actions may be taken by the affirmative vote of a majority of the votes cast by the holders of shares of the Corporation entitled to vote thereon: (1) the adoption by the stockholders of a proposed amendment of this Restated Certificate of Incorporation; (2) the approval by the stockholders of a proposed plan of merger or consolidation; (3) the approval by the stockholders of a sale, lease, exchange, or other disposition of all, or substantially all, the assets of the Corporation, if not in the usual and regular course of business as conducted by the Corporation; (4) the approval by the stockholders of a proposed plan of exchange; or (5) the approval by the stockholders of a proposed dissolution.

Optional rights to purchase shares of Common Stock may be granted, on such terms, at such price, in such manner and at such time or times as may be expressed in a resolution or resolutions adopted by the Board of Directors, and warrants or other evidence of such optional rights may be issued.

The Corporation shall not be required to issue any fraction of a share of Common Stock of the Corporation.

ARTICLE V: BY-LAWS

The Board of Directors shall have power to make, alter and repeal By-Laws; but By-Laws made by the directors may be altered or repealed by the stockholders. Notwithstanding anything contained in this Restated Certificate of Incorporation or the By-Laws of the Corporation to the contrary (and notwithstanding that a lesser percentage may be specified by law or the By-Laws), Article II of the By-Laws shall not be altered, amended or repealed by the Board of Directors and no provision inconsistent therewith shall be adopted by the Board of Directors without the affirmative vote of a majority of the entire Board of Directors.

ARTICLE VI: DIRECTORS

Subject to the rights of holders of any one or more series of Preferred Stock issued by the Corporation, the number of directors of the Corporation shall be such number, not less than three nor more than eighteen, as may, from time to time, be determined in accordance with the By-Laws. The By-Laws shall prescribe the manner in which the number of directors necessary to constitute a quorum of the Board of Directors shall be determined, which number may be less than a majority of the whole Board of Directors. The By-Laws shall also prescribe the manner in which the retirement age of and other restrictions and qualifications for directors of the Corporation shall be determined. Advance notice of nomination by a stockholder for the election of directors shall be made in the manner provided in the By-Laws.

At each annual meeting of stockholders, the directors shall be elected for terms expiring at the next annual meeting of stockholders. Any vacancies in the Board of Directors, by reason of an increase in the number of directors or otherwise, shall be filled solely by the Board of Directors, by majority vote of the directors then in office, though less than a quorum, but any such director so elected shall hold office only until the next succeeding annual meeting of stockholders. At such annual meeting, such director or a successor to such director shall be elected and qualified. No decrease in the number of directors shall shorten the term of any incumbent director.

Any director may be removed from office as a director by the affirmative vote of the stockholders but only for cause.

The Board of Directors, by vote of a majority of the whole Board, may appoint from the directors an executive committee and such other committees as they may deem judicious; and to such extent as shall be provided in the resolution of the Board or in the By-Laws, may delegate to such committees all or any of the authority of the Board of Directors which may be lawfully delegated, and such committees shall have and thereupon may exercise all or any of the authority so delegated to them. The Board of Directors of the Corporation or the By-Laws may provide the number of members necessary to constitute a quorum of any committee and the number of affirmative votes necessary for action by any committee.

Any officer and any employee elected or appointed by the Board of Directors may be removed (except from the office of director) at any time by a vote of a majority of the whole Board of Directors. Any other employee of the Corporation may be removed at any time by vote of the Board of Directors or by any committee or officer or employee upon whom such power of removal may be conferred by the By-Laws or by vote of the Board of Directors.

The Board of Directors shall from time to time determine whether and to what extent and at what times and places and under what conditions and regulations the accounts, books and records of the Corporation or any of them shall be open to the inspection of the stockholders; and no stockholder shall have any right of inspecting any account or book or document or record of the Corporation except as conferred by statute or authorized by the Board of Directors or by a resolution of the stockholders.

No contract or other transaction of the Corporation shall be affected by the fact that any of the directors of the Corporation are in any way interested in or connected with any other party to such contract or transaction, or are themselves parties to such contract or transaction, provided that at the meeting of the Board of Directors or of the committee thereof authorizing or confirming such contract or transaction there shall be present a quorum of directors not so interested or connected, and such contract or transaction shall be approved by a majority of such quorum, which majority shall consist of directors not so interested or connected.

Notwithstanding the foregoing, whenever the holders of any one or more series of Preferred Stock issued by the Corporation, pursuant to Article IV hereof, shall have the right, voting separately as a class or by series, to elect directors at an annual or special meeting of stockholders, the election, term of office, filling of vacancies and other features of such directorships shall be governed by the terms of the series of Preferred Stock applicable thereto.

ARTICLE VII: DURATION

The duration of the Corporation shall be perpetual.

ARTICLE VIII: AMENDMENTS

The Corporation reserves the right to amend, alter, change or repeal any of the provisions contained in this Restated Certificate of Incorporation in the manner now or hereafter prescribed by law, and all rights conferred on officers, directors and/or stockholders herein are granted subject to this reservation.

ARTICLE IX: STOCKHOLDER ACTION

Any action required or permitted to be taken by the stockholders of the Corporation must be effected at a duly called annual or special meeting of such stockholders and may not be effected by any consent in writing by such stockholders.

ARTICLE X: PURCHASES OF STOCK OF THE CORPORATION

(A) Except as otherwise expressly provided in this Article X, the Corporation may not purchase any shares of Common Stock at a per-share price in excess of the Fair Market Price (as hereinafter defined) as of the time of such purchase from a person known by the Corporation to be a Substantial Stockholder (as hereinafter defined), unless such purchase has been approved by the affirmative vote of the holders of at least two-thirds of the shares of Common Stock voted thereon held by Disinterested Stockholders (as hereinafter defined). Such affirmative vote shall be required notwithstanding the fact that no vote may be required or that a lesser percentage may be specified by law, in this Restated Certificate of Incorporation or in any agreement with any national securities exchange or otherwise.

(B) The provisions of this Article X shall not apply to (1) any purchase pursuant to an offer to purchase which is made on the same terms and conditions to the holders of all of the outstanding shares of Common Stock or (2) any open market purchase that constitutes a Public Transaction (as hereinafter defined).

(C) For the purposes of this Article X:

1. "Person" shall mean any individual, firm, trust, partnership, association, corporation or other entity.

2. "Substantial Stockholder" shall mean any person (other than any employee benefit plan or trust of the Corporation or any similar entity) who or which:

(a) is the beneficial owner of more than 5% of the combined voting power of the then outstanding Common

Stock, the acquisition of any shares of which has occurred within the two-year period immediately prior to the date on which the Corporation purchases any such shares; or

(b) is an assignee of or has otherwise succeeded to the beneficial ownership of any shares of Common Stock beneficially owned by a Substantial Stockholder, unless such assignment or succession shall have occurred pursuant to a Public Transaction or any series of transactions involving a Public Transaction and, with respect to all shares of Common Stock owned by such person, has been the beneficial owner of any such shares for a period of less than two years (including, for these purposes, the holding period of the Substantial Stockholder from whom such person acquired shares).

For the purposes of determining whether a person is a Substantial Stockholder, the number of shares of Common Stock deemed to be outstanding shall include shares deemed owned through application of subparagraph 4 below but shall not include any other shares of Common Stock which may be issuable pursuant to any agreement, arrangement or understanding, or upon exercise of conversion rights, warrants or options, or otherwise.

3. "Public Transaction" shall mean any (a) purchase of shares offered pursuant to an effective registration statement under the Securities Act of 1933 or (b) open market purchase of shares on a national securities exchange if, in either such case, the price and other terms of sale are not negotiated by the purchaser and the seller of the beneficial interest in the shares.

4. A person shall be a "beneficial owner" of any Common Stock:

(a) which such person or any of its Affiliates or Associates beneficially owns, directly or indirectly; or

(b) which such person or any of its Affiliates or Associates has (i) the right to acquire (whether such right is exercisable immediately or only after the passage of time) pursuant to any agreement, arrangement or understanding or upon the exercise of conversion rights, exchange rights, warrants or options, or otherwise, or (ii) the right to vote or to direct the voting thereof pursuant to any agreement, arrangement or understanding; or

(c) which is beneficially owned, directly or indirectly, by any other person with which such person or any of its Affiliates or Associates has any agreement, arrangement or understanding for the purpose of acquiring, holding, voting or disposing of any shares of Common Stock.

5. "Affiliate" and "Associate" shall have the respective meanings ascribed to such terms in Rule 12b-2 of the General Rules and Regulations under the Securities Exchange Act of 1934, as in effect on January 1, 1985.

6. "Disinterested Stockholders" shall mean those holders of Common Stock who are not Substantial Stockholders.

7. "Fair Market Price" shall mean the highest closing sale price on the Composite Tape for New York Stock Exchange-Listed Stocks during the 30-day period immediately preceding the date in question of a share of Common Stock or, if such stock is not quoted on the Composite Tape, on the New York Stock Exchange or, if such stock is not listed on such Exchange, the fair market value on the date in question of a share of such stock as determined by a majority of the Board of Directors in good faith.

(D) A majority of the Board of Directors shall have the power and duty to determine for the purposes of this Article X, on the basis of information known to them after reasonable inquiry, all facts necessary to determine compliance with this Article X, including without limitation, (1) whether a person is a Substantial Stockholder, (2) the number of shares of Common Stock beneficially owned by any person, (3) whether a person is an Affiliate or Associate of another, (4) whether a price is in excess of the Fair Market Price, (5) whether a purchase constitutes a Public Transaction and (6) such other matters with respect to which a determination is required under this Article X. The good faith determination of a majority of the Board of Directors on such matters shall be conclusive and binding for all purposes of this Article X.

(E) Nothing contained in this Article X shall be construed to relieve a Substantial Stockholder from any fiduciary obligation imposed by law.

ARTICLE XI: DIRECTOR AND OFFICER LIABILITY

To the fullest extent permitted by the laws of the State of New Jersey, as they exist or may hereafter be amended, all current and former directors and officers of the Corporation shall not be personally liable to the Corporation or its stockholders for damages for breach of any duty owed to the Corporation or its stockholders, except that the provisions of this Article XI shall not relieve a director or officer from liability for any breach of duty based upon an act or omission (a) in breach of such person's duty of loyalty to the Corporation or its stockholders, (b) not in good faith or involving a knowing violation of law or (c) resulting in receipt by such person of an improper personal benefit.

ARTICLE XII: DIRECTORS

The number of directors constituting the current Board of Directors of the Corporation is eighteen. The names and addresses of said directors are as follows:

Leslie A. Brun	435 Devon Park Drive, 700 Building Wayne, Pennsylvania 19087
Thomas R. Cech, Ph.D.	University of Colorado, Boulder Boulder, Colorado 80309-0215
Richard T. Clark	One Merck Drive Whitehouse Station, New Jersey 08889-0100
Thomas H. Glocer	3 Times Square, 30th Floor New York, New York 10036
Steven F. Goldstone	570 Lexington Avenue, 37th Floor New York, New York 10022
William B. Harrison, Jr.	277 Park Avenue, 35th Floor New York, New York 10172
Harry R. Jacobson, M.D.	3401 West End Avenue, Suite 300 Nashville, Tennessee 37203
William N. Kelley, M.D.	421 Curie Boulevard Philadelphia, Pennsylvania 19104-6160
C. Robert Kidder	One Merck Drive Whitehouse Station, New Jersey 08889-0100
Rochelle B. Lazarus	636 11th Avenue New York, New York 10036
Carlos E. Represas	Av. Ejercito Nacional No. 453 Colonia Granada, 11520 Mexico, D.F. Mexico
Patricia F. Russo	One Merck Drive Whitehouse Station, New Jersey 08889-0100
Thomas E. Shenk, Ph.D	Washington Road Princeton, New Jersey 08544-1014
Anne M. Tatlock	One Merck Drive Whitehouse Station, New Jersey 08889-0100

Samuel O. Thier, M.D.	55 Fruit Street, Bulfinch 370 Boston, Massachusetts 02114-2606
Craig B. Thompson, M.D.	One Merck Drive Whitehouse Station, New Jersey 08889-0100
Wendell P. Weeks	1 Riverfront Plaza Corning, New York 14831
Peter C. Wendell	2884 Sand Hill Road, Suite 100 Menlo Park, California 94025

IN WITNESS WHEREOF, Schering-Plough Corporation has caused this Restated Certificate of Incorporation to be duly executed as of November 2nd, 2009.

SCHERING-PLOUGH CORPORATION

By: [signature]

Name: Susan Ellen Wolf

Title: Corporate Secretary
VP, Corporate Governance
and Associate General Counsel

ANNEX A

6.00% Mandatory Convertible Preferred Stock

(1) **Designation and Amount.** This series of Preferred Shares shall be designated as "6.00% Mandatory Convertible Preferred Stock" (the "CONVERTIBLE PREFERRED STOCK") and the number of shares constituting such series shall be 11,500,000, with a par value of $1.00 per share.

(2) **Ranking.** The Convertible Preferred Stock shall rank, as to payment of dividends and distribution of assets upon dissolution, liquidation or winding up of the Corporation, (a) senior to (i) the Common Stock and (ii) any class or series of capital stock issued by the Corporation which by its terms ranks junior to the Convertible Preferred Stock (collectively, the "JUNIOR SECURITIES"), (b) junior to any class or series of capital stock issued by the Corporation which by its terms ranks senior to the Convertible Preferred Stock (the "SENIOR SECURITIES"), and (c) pari passu with any other class or series of capital stock issued by the Corporation not included in clauses (a) or (b) of this paragraph (the "PARITY SECURITIES"), in each case, whether now outstanding or to be issued in the future.

(3) **Dividends.**

(a) Dividends on the Convertible Preferred Stock will be payable quarterly when, as and if declared by the Board, or a duly authorized committee thereof, when the Corporation is legally permitted to do so, on each Dividend Payment Date, at the annual rate of 6.00% per year on the Liquidation Preference. The initial dividend on the Convertible Preferred Stock for the first Dividend Period, commencing on the date of first issuance of the Convertible Preferred Stock (assuming a date of first issuance of August 15, 2007), to but excluding November 15, 2007, will be $3.75 per share, subject to adjustment as provided for in Section 18(c), and when, as and if declared, will be payable on November 15, 2007; PROVIDED that the Corporation is legally permitted to pay such dividends at such time. Each subsequent quarterly dividend on the Convertible Preferred Stock, when, as and if declared (other than the dividend payable on the Mandatory Conversion Date), will be $3.75 per share, subject to adjustment as provided for in Section 18(c). The dividend payable on the Mandatory Conversion Date will be $3.67 per share, subject to adjustment as provided for in Section 18(c). Dividends payable, when, as and if declared, on a Dividend Payment Date will be payable to Record Holders for the applicable Dividend Payment Date, except as otherwise provided in Section 6(a).

(b) The amount of dividends payable for any period that is shorter or longer than a full quarterly dividend period will be computed on the basis of a 360-day year consisting of twelve 30-day months. Dividends on the Convertible Preferred Stock shall accrue and cumulate if the Corporation fails to declare one or more dividends on the Convertible Preferred Stock in any amount, whether or not the Corporation is then legally permitted to pay such dividends.

(c) No interest or sum of money in lieu of interest shall be payable in respect of any dividend not paid on a Dividend Payment Date or any other late payment. The Corporation will also not pay Holders of the Convertible Preferred Stock any dividend in excess of the full dividends on the Convertible Preferred Stock that are payable as described above.

(d) Dividends in arrears on the Convertible Preferred Stock not declared for payment or not paid on any Dividend Payment Date may later be declared by the Board, or a duly authorized committee thereof, and paid on any date fixed by the Board, or a duly authorized committee thereof, whether or not a Dividend Payment Date, to the Holders of record as they appear on the stock register of the Corporation on a record date selected by the Board, or a duly authorized committee thereof, which shall (i) not precede the date the Board, or an authorized committee thereof, declares the dividend payable and (ii) not be more than 60 days prior to the date the dividend is paid.

(e) There is no sinking fund with respect to dividends.

(4) **Payment Restrictions.**

(a) Unless all accrued, cumulated and unpaid dividends on the Convertible Preferred Stock for all prior Dividend Periods have been paid, the Corporation may not:

(i) declare or pay any dividend or make any distribution of assets on any Junior Securities, other than dividends or distributions in the form of Junior Securities and cash solely in lieu of fractional shares in connection with any such dividend or distribution;

(ii) redeem, purchase or otherwise acquire any Junior Securities or pay or make any monies available for a sinking fund for such Junior Securities, other than (A) upon conversion or exchange for other Junior Securities or (B) the purchase of fractional interests in shares of any Junior Securities pursuant to the conversion or exchange provisions of such Junior Securities;

(iii) declare or pay any dividend or make any distribution of assets on any Parity Securities, other than dividends or distributions in the form of Parity Securities or Junior Securities and cash solely in lieu of fractional shares in connection with any such dividend or distribution; or

(iv) redeem, purchase or otherwise acquire any Parity Securities, except upon conversion into or exchange for other Parity Securities or Junior Securities and cash solely in lieu of fractional shares in connection with any such conversion or exchange, PROVIDED, HOWEVER, that a redemption, purchase or other acquisition of Parity Securities upon conversion into or exchange for other Parity Securities is only permitted if (A) the aggregate amount of the liquidation preference of such other Parity Securities does not exceed the aggregate amount of the liquidation preference, plus accrued, cumulated and unpaid dividends, of the Parity Securities that are converted into or exchanged for such other Parity Securities, (B) the aggregate number of shares of Common Stock issuable upon conversion, redemption or exchange of such other Parity Securities does not exceed the aggregate number of shares of Common Stock issuable upon conversion, redemption or exchange of the Parity Securities that are converted into or exchanged for such other Parity Securities and (C) such other Parity Securities contain terms and conditions (including, without limitation, with respect to the payment of dividends, dividend rates, liquidation preferences, voting and representation rights, payment restrictions, anti-dilution rights, change of control rights, covenants, remedies and conversion and redemption rights) that are not materially less favorable, taken as a whole, to the Corporation or the Holders of the Convertible Preferred Stock than those contained in the Parity Securities that are converted or exchanged for such other Parity Securities.

(5) **Voting Rights.**

(a) Except as otherwise required by law, the Certificate of Incorporation or set forth in this Section 5, Holders of the Convertible Preferred Stock are not entitled to any voting rights and their consent shall not be required for the taking of any corporate action.

(b) So long as any shares of Convertible Preferred Stock are outstanding, the Corporation will not, without the approval of the Holders of at least two-thirds of the shares of Convertible Preferred Stock then outstanding, given in person or by proxy either at an annual meeting or at a special meeting called for that purpose, at which the Holders of the Convertible Preferred Stock shall vote separately as a single class, amend, alter or repeal (by merger, consolidation, combination, reclassification or otherwise) any of the provisions of the Certificate of Incorporation so as to affect adversely the rights, preferences or voting powers of the Holders of the Convertible Preferred Stock; PROVIDED that any amendment of the provisions of the Certificate of Incorporation so as to issue, authorize or increase the authorized amount of, or issue or authorize any obligation or security convertible into or evidencing a right to purchase, any Parity Securities or Junior Securities shall be deemed not to affect adversely the rights, preferences or voting powers of the Holders of the Convertible Preferred Stock. Notwithstanding anything in this Section 5 to the contrary, any amendment, alteration or repeal of any of the provisions of the Certificate of Incorporation occurring in connection with any merger or consolidation of the Corporation of the type described in Section 14(e)(i) or any statutory exchange of securities of the Corporation with another Person (other than in connection with a merger or acquisition) of the type described in Section 14(e)(iv) shall be deemed not to adversely affect the rights, preferences or voting power of the Holders of the Convertible Preferred Stock, PROVIDED that, subject to Section 10, in the event the Corporation does not survive the transaction, the shares of the Convertible Preferred Stock will become shares of the successor Person, having in respect of such successor Person the same rights, preferences or voting powers of the Holders of the Convertible Preferred Stock immediately prior to the consummation of such merger, consolidation, or statutory exchange and shall be convertible into the kind and amount of net cash, securities and other property as determined in accordance with Section 14(e) hereof, PROVIDED FURTHER that following any such merger, consolidation or statutory exchange, such successor Person shall succeed to and be substituted for, and may exercise all of the rights and powers of the Corporation under, the Convertible Preferred Stock.

(c) If at any time dividends on the then-outstanding shares of Convertible Preferred Stock or any other class or series of Preferred Shares in an amount equivalent to six quarterly dividends, whether or not consecutive, shall not have been (i) paid or (ii)(A) declared and (B) a sum sufficient for the payment thereof set aside, the holders of Preferred Shares (including the Convertible Preferred Stock), voting separately as a single class, shall be entitled to increase the authorized number of directors on the Board by two and elect such two directors (the "PREFERRED STOCK DIRECTORS") at the next annual or special meeting of the shareholders called in the manner described below. At any such annual or special meeting of the shareholders, or any adjournment thereof, if the holders of at least a majority of the Preferred Shares then outstanding shall be present or represented by proxy, then, (1) by vote of the holders of at least a majority of the

Preferred Shares, voting as a class, then present or so represented, the authorized number of directors of the Corporation shall be increased by two, and (2) at such meeting the holders of the Preferred Shares, voting as a class, shall be entitled to elect the Preferred Stock Directors by vote of the holders of at least a majority of the Preferred Shares then present or so represented. Such right of the holders of the Preferred Shares to elect the Preferred Stock Directors may be exercised until all dividends in default on such Preferred Shares shall have been (i) paid in full or (ii)(A) declared and (B) a sum sufficient for the payment thereof set aside. When so paid or provided for, (i) the right of the holders of Preferred Shares to elect the Preferred Stock Directors shall cease, (ii) the terms of all of the Preferred Stock Directors shall terminate at the next annual meeting, and (iii) the authorized number of directors of the Corporation shall be reduced accordingly. Not later than 40 days after such entitlement arises, the Board will convene a special meeting of the holders of Preferred Shares for the above purpose. If the Board fails to convene such meeting within such 40-day period, the holders of 10% of the outstanding Preferred Shares, considered as a single class, will be entitled to convene such meeting to elect the initial Preferred Stock Directors. Any director who shall have been elected by the holders of Preferred Shares as a class pursuant to this Section 5(c) may be removed at any time, either for or without cause by, and only by, the affirmative vote of the holders of record of a majority of the outstanding Preferred Shares given at a special meeting of such shareholders called for such purpose by the Corporation or at the annual meeting of shareholders, and any vacancy created by such removal may also be filled at such meeting. Any vacancy caused by the death or resignation of a director who shall have been elected by the holders of Preferred Shares as a class pursuant to this Section 5(c) may be filled only by the holders of outstanding Preferred Shares at a meeting called for such purpose. The provisions of the Certificate of Incorporation and By-laws of the Corporation relating to the convening and conduct of special meetings of shareholders and the nomination of directors will apply with respect to any special meeting of the holders of Preferred Shares; PROVIDED that the notice of the nomination need only be delivered to the Secretary of the Corporation not more than 10 days after the Corporation (or the holders of 10% of the outstanding Preferred Shares, if applicable) has notified the holders of Preferred Shares of the date of the special meeting to elect the initial Preferred Stock Directors.

(d) So long as any of the Convertible Preferred Stock is outstanding, the Corporation will not, without the approval of the Holders of at least two-thirds of the shares of Convertible Preferred Stock then outstanding and any class or series of Parity Securities then outstanding, voting together as a single class, given in person or by proxy either at an annual meeting or at a special meeting called for that purpose:

(i) reclassify any of the Corporation's authorized shares into any shares of any class, or any obligation or security convertible into or evidencing a right to purchase such shares, ranking senior to the Convertible Preferred Stock as to payment of dividends or distribution of assets upon the dissolution, liquidation or winding up of the Corporation; or

(ii) issue, authorize or increase the authorized amount of, or issue or authorize any obligation or security convertible into or evidencing a right to purchase, any stock of any class or series ranking senior to the Convertible Preferred Stock as to payment of dividends or distribution of assets upon the dissolution, liquidation or winding up of the Corporation; PROVIDED that the Corporation may issue, authorize or increase the authorized amount of, or issue or authorize any obligation or security convertible into or evidencing a right to purchase, any shares of capital stock ranking on a parity with or junior to the Convertible Preferred Stock as to payment of dividends or distribution of assets upon the dissolution, liquidation or winding up of the Corporation without the vote of the Holders of the Convertible Preferred Stock.

(e) In exercising the voting rights set forth in this Section 5, each share of Convertible Preferred Stock shall have one vote per share. In any case where the Holders of the Convertible Preferred Stock are entitled to vote as a class with holders of Parity Securities or other classes or series of Preferred Shares, each class or series shall have a number of votes proportionate to the aggregate liquidation preference of its outstanding shares.

(6) **Liquidation, Dissolution or Winding Up.**

(a) In the event of any voluntary or involuntary liquidation, dissolution or winding up of the Corporation, subject to the rights of holders of any shares of capital stock of the Corporation then outstanding ranking senior to or pari passu with the Convertible Preferred Stock in respect of distributions upon liquidation, dissolution or winding up of the Corporation and before any amount shall be paid or distributed with respect to holders of any shares of capital stock of the Corporation then outstanding ranking junior to the Convertible Preferred Stock in respect of distributions upon liquidation, dissolution or winding up of the Corporation, the Holders of the Convertible Preferred Stock at the time outstanding will be entitled to receive, out of the net assets of the Corporation legally available for distribution to shareholders, the Liquidation Preference, plus an amount equal to the sum of all accrued, cumulated and unpaid dividends, whether or not declared, for the portion of the then-current Dividend Period until the payment date and all prior Dividend Periods and such Holders shall be deemed to be the Holders of record for such Dividend Periods or portions thereof. After the payment to the Holders of the Convertible Preferred Stock of the full amounts provided for in this Section 6(a), the Holders of the Convertible Preferred Stock will have no right or claim to any of the Corporation's remaining assets.

(b) For the purpose of this Section 6, none of the following shall constitute or be deemed to constitute a voluntary or involuntary liquidation, dissolution or winding up of the Corporation:

(i) the sale, transfer, lease or conveyance of all or substantially all of the Corporation's property or business;

(ii) the consolidation or merger of the Corporation with or into any other Person; or

(iii) the consolidation or merger of any other Person with or into the Corporation.

(c) If, upon any voluntary or involuntary liquidation, dissolution or winding up of the Corporation, the amounts payable with respect to the Convertible Preferred Stock then outstanding are not paid in full as provided in Section 6(a) hereof, no distribution shall be made on account of any securities ranking pari passu with the Convertible Preferred Stock as to the distribution of assets upon such liquidation, dissolution or winding up, unless a pro rata distribution is made on the Convertible Preferred Stock. The Holders of the Convertible Preferred Stock then outstanding and the holders of any such securities then outstanding shall share ratably in any distribution of assets upon such liquidation, dissolution or winding up. The amount allocable to each series of such securities then outstanding will be based on the proportion of their full respective liquidation preference to the aggregate liquidation preference of the outstanding shares of each such series.

(d) Written notice of any voluntary or involuntary liquidation, dissolution or winding up of the Corporation, stating the payment date or dates when, and the place or places where, the amounts distributable to holders of Convertible Preferred Stock in such circumstances shall be payable, shall be given by first-class mail, postage prepaid, mailed not less than twenty calendar days prior to any payment date stated therein, to the Holders of Convertible Preferred Stock, at the address shown on the books of the Corporation or the Transfer Agent; PROVIDED, HOWEVER, that a failure to give notice as provided above or any defect therein shall not affect the Corporation's ability to consummate a voluntary or involuntary liquidation, dissolution or winding up of the Corporation.

(7) **Mandatory Conversion on the Mandatory Conversion Date.**

(a) Each share of Convertible Preferred Stock will automatically convert (unless previously converted at the option of the Holder in accordance with Section 8 hereof, at the option of the Corporation pursuant to Section 9 or Section 10A hereof or pursuant to a Make-Whole Acquisition Conversion in accordance with Section 10 hereof) on the Mandatory Conversion Date, into a number of shares of Common Stock equal to the Conversion Rate.

(b) The "CONVERSION RATE" shall be as follows:

(i) if the Applicable Market Value of the Common Stock is equal to or greater than $33.69 (the "THRESHOLD APPRECIATION PRICE"), then the Conversion Rate shall be equal to 7.4206 shares of Common Stock per share of Convertible Preferred Stock (the "MINIMUM CONVERSION RATE"), which is equal to $250.00 divided by the Threshold Appreciation Price;

(ii) if the Applicable Market Value of the Common Stock is less than the Threshold Appreciation Price but greater than $27.50 (the "INITIAL PRICE"), then the Conversion Rate shall be equal to $250.00 divided by the Applicable Market Value of the Common Stock;

(iii) if the Applicable Market Value of the Common Stock is less than or equal to the Initial Price, then the Conversion Rate shall be equal to 9.0909 shares of Common Stock per share of Convertible Preferred Stock (the "MAXIMUM CONVERSION RATE"), which is equal to $250.00 divided by the Initial Price; and

(iv) the Minimum Conversion Rate, the Maximum Conversion Rate, the Threshold Appreciation Price and the Initial Price are each subject to adjustment in accordance with the provisions of Section 14 hereof.

(c) In addition to the shares issuable or the Mandatory Conversion Date pursuant to Section 7(a), the Holders of Convertible Preferred Stock on the Mandatory Conversion Date shall have the right to receive on the Mandatory Conversion Date an amount in cash equal to the sum of (i) all accrued, cumulated and unpaid dividends that have not been declared on the shares of Convertible Preferred Stock then outstanding for all Dividend Periods up to and excluding the Mandatory Conversion Date, plus (ii) any declared but unpaid dividends if the Holder was the Record Holder on the Record Date relating to such dividends; PROVIDED that the Corporation is legally permitted to pay such dividends at such time.

(d) On the Mandatory Conversion Date, certificates representing the shares of Common Stock into which the Convertible Preferred Stock has been converted will be issued and delivered to the Holders upon receipt by the Transfer Agent of any certificate(s) representing share(s) of Convertible Preferred Stock to be converted (if held in certificated form) surrendered by the Holder and any other transfer forms, tax forms or other relevant documentation required and specified by the Transfer Agent, if necessary, to effect the conversion.

(8) **Early Conversion at the Option of the Holder.**

(a) Shares of the Convertible Preferred Stock are convertible, in whole or in part at the option of the Holder thereof ("EARLY CONVERSION") at any time prior to the Mandatory Conversion Date, into shares of Common Stock at the Minimum Conversion Rate, subject to adjustment as set forth in Section 14 hereof.

(b) Any written notice of conversion pursuant to Section 8 hereof shall be duly executed by the Holder, and specify:

(i) the number of shares of Convertible Preferred Stock to be converted;

(ii) the name(s) in which such Holder desires the shares of Common Stock issuable upon conversion to be registered (subject to compliance with applicable legal requirements if any of such certificates are to be issued in a name other than the name of the Holder);

(iii) if certificates are to be issued, the address to which such Holder wishes delivery to be made of such new certificates to be issued upon such conversion; and

(iv) any other transfer forms, tax forms or other relevant documentation required and specified by the Transfer Agent, if necessary, to effect the conversion.

(c) If specified by the Holder in the notice of conversion that shares of Common Stock issuable upon conversion of the Convertible Preferred Stock shall be issued to a person other than the Holder surrendering the shares of Convertible Preferred Stock being converted, the Holder shall pay or cause to be paid any transfer or similar taxes payable in connection with the shares of Common Stock so issued.

(d) Upon receipt by the Transfer Agent of (i) a completed and duly executed notice of conversion as set forth in Section 8(b), (ii) confirmation by the Holder of the payment of any transfer or similar taxes in compliance with Section 8(c) (if applicable), (iii) any certificate(s) representing share(s) of Convertible Preferred Stock to be converted (if held in certificated form) surrendered by the Holder, (iv) any appropriate endorsements and transfer documents from the Holder (if applicable); and (v) if such dividend has been declared, payment from the Holder of an amount in cash equal to the full dividend payable on the Dividend Payment Date for the then-current Dividend Period on the Convertible Preferred Stock being converted, the Corporation shall, within three Business Days or as soon as possible thereafter, issue and shall instruct the Transfer Agent to register the number of shares of Common Stock to which such Holder shall be entitled upon conversion in the name(s) specified by such Holder in the notice of conversion. If a Holder elects to hold its shares of Common Stock issuable upon conversion of the Convertible Preferred Stock in certificated form, the Corporation shall promptly send or cause to be sent, by hand delivery (with receipt to be acknowledged) or by first-class mail, postage prepaid, to the Holder thereof, at the address designated by such Holder in the written notice of conversion, a certificate or certificates representing the number of shares of Common Stock to which such Holder shall be entitled upon conversion. In the event that there shall have been surrendered a certificate or certificates representing shares of Convertible Preferred Stock, only part of which are to be converted, the Corporation shall issue and deliver to such Holder or such Holder's designee in the manner provided in the immediately preceding sentence a new certificate or certificates representing the number of shares of Convertible Preferred Stock that shall not have been converted.

(e) The issuance by the Corporation of shares of Common Stock upon a conversion of shares of Convertible Preferred Stock in accordance with the terms hereof shall be deemed effective immediately prior to the close of business on the day of receipt by the Transfer Agent of the notice of conversion and other documents or payments, if any, set forth in Section 8(b) and 8(d) hereof, compliance with Section 8(c), if applicable, and the surrender by such Holder or such Holder's designee of the certificate or certificates representing the shares of Convertible Preferred Stock to be converted (if held in certificated form), duly assigned or endorsed for transfer to the Corporation (or accompanied by duly executed stock powers relating thereto).

(f) A Holder of a share of Convertible Preferred Stock then outstanding on the Early Conversion Date with respect to such share shall have the right to receive an amount in cash equal to all accrued, cumulated and unpaid dividends that have not been declared for all prior Dividend Periods ending on or prior to the Dividend Payment Date immediately preceding the Early Conversion Date. If the Early Conversion Date is prior to the Record Date for the Dividend Period in which a Holder elects to exercise an Early Conversion, such Holder will not receive any declared dividends for that Dividend Period. If the Early Conversion Date is after the Record Date for any declared but unpaid dividend, a Holder exercising its Early Conversion right will receive that dividend on the relevant Dividend Payment Date if it was the Record Holder on the Record Date for that dividend; however, whether or not such Holder was the Record Holder on the Record Date for that dividend, such Holder must pay to the Transfer Agent, on or prior to the Early Conversion Date, an amount in cash equal to the full dividend payable on the Dividend Payment Date for the then-current Dividend Period on the Convertible Preferred Stock that is being converted by such Holder. Holders will only receive dividends if the Corporation is then legally permitted to pay such dividends.

(9) **Provisional Conversion.**

(a) Prior to the Mandatory Conversion Date, if the Closing Price of the Common Stock has exceeded 150% of the Threshold Appreciation Price for at least 20 Trading Days within a period of 30 consecutive Trading Days ending on the Trading Day prior to the date (the "PROVISIONAL CONVERSION NOTICE DATE") on which the Corporation notifies the Holders (pursuant to clause (b) below) that it is exercising its option to cause the conversion of the Convertible Preferred Stock pursuant to this Section 9, the Corporation may, at its option, cause the conversion of all, but not less than all, the shares of Convertible Preferred Stock then outstanding into shares of Common Stock at the Minimum Conversion Rate for each share of Convertible Preferred Stock, subject to adjustment as set forth in Section 14. The Corporation shall be able to cause this conversion only if, in addition to issuing the Holders shares of Common Stock, the Corporation is then legally permitted to, and does, pay the Holders in cash an amount equal to the sum of (i) all accrued, cumulated and unpaid dividends on the shares of Convertible Preferred Stock then outstanding that have not been declared for all Dividend Periods to, but excluding, the Provisional Conversion Date, plus (ii) if the Provisional Conversion Date is prior to the Record Date for any declared dividend, all accrued, cumulated and unpaid dividends on the shares of Convertible Preferred Stock then outstanding that have been declared for all Dividend Periods to, but excluding, the Provisional Conversion Date, plus (iii) the present value of all remaining future dividend payments on the shares of Convertible Preferred Stock then outstanding through and including the Mandatory Conversion Date (excluding (A) any unpaid dividends accrued during the portion of the then-current Dividend Period through, but excluding, the Provisional Conversion Date, and (B) if the Provisional Conversion Date is after the Record Date for the then-current Dividend Period, any declared and unpaid dividends for the then-current Dividend Period). The present value of all remaining future dividend payments will be computed using a discount rate equal to the Treasury Yield. If the Provisional Conversion Date is after the Record Date for any declared but unpaid dividend, a Holder will receive that dividend on the relevant Dividend Payment Date if it was the Record Holder on the Record Date for that dividend.

(b) A written notice (the "PROVISIONAL CONVERSION NOTICE") shall be sent by or on behalf of the Corporation, by first class mail, postage prepaid, to the Holders of record as they appear on the stock register of the Corporation on the Provisional Conversion Notice Date (i) notifying such Holders of the election of the Corporation to convert and of the Provisional Conversion Date, which date shall not be less than 30 days nor be more than 60 days after the Provisional Conversion Notice Date, and (ii) stating the Corporate Trust Office of the Transfer Agent at which the shares of Convertible Preferred Stock called for conversion shall, upon presentation and surrender of the certificate(s) (if such shares are held in certificated form) evidencing such shares, be converted, and the Minimum Conversion Rate to be applied thereto. The Corporation shall also issue a press release containing such information and publish such information on its website http://www.merck.com, PROVIDED that failure to issue such press release or publish such information on the Corporation's website shall not act to prevent or delay conversion pursuant to this Section 9.

(c) The Corporation shall deliver to the Transfer Agent irrevocable written instructions authorizing the Transfer Agent, on behalf and at the expense of the Corporation, to cause the Provisional Conversion Notice to be duly mailed as soon as practicable after receipt of such irrevocable instructions from the Corporation and in accordance with the above provisions. The shares of Common Stock to be issued upon conversion of the Convertible Preferred Stock pursuant to this Section 9 and cash with respect to dividends calculated pursuant to Section 9(a) shall be deposited with the Transfer Agent in trust at least one Business Day prior to the Provisional Conversion Date, for the pro rata benefit of the Holders of record as they appear on the stock register of the Corporation, so as to be and continue to be available therefor. Neither failure to mail such Provisional Conversion Notice to one or more such Holders nor any defect in such Provisional Conversion Notice shall affect the sufficiency of the proceedings for conversion as to other Holders.

(d) If a Provisional Conversion Notice shall have been given as hereinbefore provided, then each Holder shall be entitled to all preferences and relative, participating, optional and other special rights accorded by this Amended and Restated Certificate of Incorporation until immediately prior to the close of business on the Provisional Conversion Date. From and after the close of business on the Provisional Conversion Date, upon delivery by the Corporation of the Common Stock and payment of the funds to the Transfer Agent as described in paragraph (c) above, the Convertible Preferred Stock shall no longer be deemed to be outstanding, and all rights of such Holders shall cease and terminate, except the right of the Holders, upon surrender of certificates therefor, to receive Common Stock and any amounts to be paid hereunder.

(e) The deposit of monies in trust with the Transfer Agent up to the amount necessary for the Provisional Conversion shall be irrevocable except that the Corporation shall be entitled to receive from the Transfer Agent the interest or other earnings, if any, earned on any monies so deposited in trust, and the Holders of the shares converted shall have no claim to such interest or other earnings, and any balance of monies so deposited by the Corporation and unclaimed by the Holders entitled thereto at the expiration of two years from the Provisional Conversion Date shall be repaid, together with any interest or other earnings thereon, to the Corporation, and after any such repayment, the Holders of the shares entitled to the funds so repaid to the Corporation shall look only to the Corporation for such payment without interest.

(10) **Early Conversion Upon Make-Whole Acquisition.**

(a) In the event of a Make-Whole Acquisition, each Holder of Convertible Preferred Stock shall have the option to convert its shares of Convertible Preferred Stock then outstanding at the Make-Whole Acquisition Conversion Rate, as adjusted pursuant to Section 14, during a period (the "MAKE-WHOLE ACQUISITION CONVERSION PERIOD") that begins on the effective date of such

Make-Whole Acquisition and ends on the date that is 15 days after the effective date, or such earlier date ending on the earlier of the Mandatory Conversion Date and the Provisional Conversion Notice Date; PROVIDED that the Provisional Conversion Date occurs within the period contemplated by Section 9(b) hereof (such right of the Holders to convert their shares pursuant to this Section 10 being the "MAKE-WHOLE ACQUISITION CONVERSION").

(b) On or before the twentieth day prior to the date on which the Corporation anticipates consummating the Make-Whole Acquisition, a written notice (the "MAKE-WHOLE ACQUISITION CONVERSION NOTICE") shall be sent by or on behalf of the Corporation, by first-class mail, postage prepaid, to the Record Holders as they appear on the stock register of the Corporation. Such notice shall contain:

(i) the date on which the Make-Whole Acquisition is anticipated to be effected;

(ii) the Make-Whole Conversion Rate;

(iii) the amount of cash, securities and other consideration payable per share of Common Stock or Convertible Preferred Stock, respectively;

(iv) (A) the first date, which shall be the effective date of such Make-Whole Acquisition, on which the Make-Whole Acquisition Conversion option may be exercised and (B) the date, which shall be 15 days after the effective date of the Make-Whole Acquisition, by which the Make-Whole Acquisition Conversion option must be exercised; and

(v) the instructions a Holder must follow to exercise the Make-Whole Acquisition Conversion option in connection with such Make-Whole Acquisition.

(c) To exercise a Make-Whole Acquisition Conversion option, a Holder shall deliver to the Transfer Agent at its Corporate Trust Office by 5:00 p.m., New York City time on or before the date by which the Make-Whole Acquisition Conversion option must be exercised as specified in the notice, the certificate(s) (if such shares are held in certificated form) evidencing the shares of Convertible Preferred Stock or of the Successor Security with respect to which the Make-Whole Acquisition Conversion option is being exercised, duly assigned or endorsed for transfer to the Corporation or its successor, or accompanied by duly executed stock powers relating thereto, or in blank, with a written notice to the Corporation or its successor stating the Holder's intention to convert early in connection with the Make-Whole Acquisition containing the information set forth in Section 8(b) and providing the Corporation or its successor with payment instructions.

(d) If a Holder does not elect to exercise the Make-Whole Acquisition Conversion option pursuant to this Section 10, the shares of Convertible Preferred Stock or successor security held by it will remain outstanding.

(e) Upon a Make-Whole Acquisition Conversion, the Transfer Agent shall, in accordance with the instructions provided by the Holder thereof in the written notice provided to the Corporation or its successor as set forth in Section 10(c), deliver to the Holder such cash, securities or other property as are issuable with respect to shares of Common Stock in the Make-Whole Acquisition. Such delivery shall take place upon, and only to the extent of, the consummation of such Make-Whole Acquisition Conversion.

(f) In the event that a Make-Whole Acquisition Conversion is effected with respect to shares of Convertible Preferred Stock or a successor security representing less than all the shares of Convertible Preferred Stock or a successor security held by a Holder, upon such Make-Whole Acquisition Conversion the Corporation or its successor shall execute and the Transfer Agent shall, unless otherwise instructed in writing, countersign and deliver to the Holder thereof, at the expense of the Corporation, a certificate evidencing the shares of Convertible Preferred Stock or such successor security held by the Holder as to which Make-Whole Acquisition Conversion was not effected.

(g) Upon any conversion pursuant to Section 10, in addition to issuing to any converting Holders of Convertible Preferred Stock or a successor security then outstanding such cash, securities or other property as are issuable with respect to shares of Common Stock in the Make-Whole Acquisition at the Make-Whole Acquisition Conversion Rate, the Corporation or its successor shall pay such Holders in cash an amount equal to the sum of (i) all accrued, cumulated and unpaid dividends on the shares of Convertible Preferred Stock and such successor security then outstanding that have not been declared for all Dividend Periods to, but excluding, the Make-Whole Acquisition Conversion Date, plus (ii) if the Make-Whole Acquisition Conversion Date is prior to the Record Date for any declared dividend, all accrued, cumulated and unpaid dividends on the shares of Convertible Preferred Stock or such successor security then outstanding that have been declared for all Dividend Periods to, but excluding, the Make-Whole Acquisition Conversion Date, plus (iii) the present value of all remaining future dividend payments on the shares of Convertible Preferred Stock or such successor security then outstanding through and including the Mandatory Conversion Date (excluding (A) any unpaid dividends accrued during the portion of the then-current Dividend Period through, but excluding, the Provisional Conversion Date, and (B) if the Provisional Conversion Date is after the Record Date for the then-current Dividend Period, any unpaid dividends for the then-current Dividend Period), computed using a discount rate equal to 6.75%; PROVIDED, in all cases, that at such time the Corporation is then legally permitted to pay such dividends. If the Make-Whole Acquisition Conversion Date is after the Record Date for any declared dividend, a Holder will receive that dividend on the relevant Dividend Payment Date if it was the Record Holder on the Record Date for that dividend.

(10A.) **Mandatory Early Conversion Upon Certain Reorganizations.**

(a) In the event that the Corporation plans to undertake a Reorganization Event (including a Reorganization Event which constitutes a Make-Whole Acquisition) in which (i) the Corporation would not be the surviving entity, and (ii) the shares of Convertible Preferred Stock cannot become shares of the surviving entity with, in respect of such surviving entity, the same rights, preferences and voting powers as the Convertible Preferred Stock because the surviving entity shall not have the legal authority to issue, or amend its governing documents to provide for the issuance of, such shares, then the Corporation may, at its option, cause the conversion of all, but not less than all, of the shares of Convertible Preferred Stock then outstanding into shares of Common Stock at the Make-Whole Acquisition Conversion Rate as if such Reorganization Event were a Make-Whole Acquisition, subject to adjustment as set forth in Section 14 (such option of the Corporation to convert the Convertible Preferred Stock pursuant to this Section 10A being the "MANDATORY REORGANIZATION CONVERSION"), with the Mandatory Reorganization Conversion to take effect immediately prior to the closing of the Reorganization Event (the "REORGANIZATION CONVERSION DATE"). For purposes of determining the Make-Whole Acquisition Conversion Rate applicable to a Mandatory Reorganization Conversion, the "effective date" shall be the Reorganization Conversion Date and the Make-Whole Acquisition Stock Price shall be the consideration payable per Common Share in the Reorganization Event. The Corporation shall be able to cause this conversion only if, in addition to issuing the Holders shares of Common Stock, the Corporation is then legally permitted to, and does, pay the Holders in cash an amount equal to the sum of (i) all accrued, cumulated and unpaid dividends on the shares of Convertible Preferred Stock then outstanding that have not been declared for all Dividend Periods to, but excluding, the

Reorganization Conversion Date, plus (ii) if the Reorganization Conversion Date is prior to the Record Date for any declared dividend, all accrued, cumulated and unpaid dividends on the shares of Convertible Preferred Stock then outstanding that have been declared for all Dividend Periods to, but excluding, the Reorganization Conversion Date, plus (iii) the present value of all remaining future dividend payments on the shares of Convertible Preferred Stock then outstanding through and including the Mandatory Conversion Date (excluding (A) any unpaid dividends accrued during the portion of the then-current Dividend Period through, but excluding, the Reorganization Conversion Date, and (B) if the Reorganization Conversion Date is after the Record Date for the then-current Dividend Period, any unpaid dividends for the then-current Dividend Period). The present value of all remaining future dividend payments will be computed using a discount rate equal to 6.75%. If the Reorganization Conversion Date is after the Record Date for any declared dividend, a Holder will receive that dividend on the relevant Dividend Payment Date if it was the Record Holder on the Record Date for that dividend.

(b) A written notice (the "REORGANIZATION CONVERSION NOTICE"), which may be contingent on the closing of the reorganization transaction and which shall be irrevocable, shall be sent by or on behalf of the Corporation, by first class mail, postage prepaid, (the Trading Day prior to the date on which such notice is mailed being the "REORGANIZATION CONVERSION NOTICE DATE") to the Holders of record as they appear on the stock register of the Corporation on the Reorganization Conversion Notice Date (i) notifying such Holders of the election of the Corporation to convert and of the anticipated Reorganization Conversion Date, which date shall not be less than 30 days nor be more than 60 days after the Reorganization Conversion Notice Date, and (ii) stating the Corporate Trust Office of the Transfer Agent at which the shares of Convertible Preferred Stock called for conversion shall, upon presentation and surrender of the certificate(s) (if such shares are held in certificated form) evidencing such shares, be converted, and the Make-Whole Acquisition Conversion Rate to be applied thereto. The Corporation shall also issue a press release containing such information and publish such information on its website on the World Wide Web, PROVIDED that failure to issue such press release or publish such information on the Corporation's website shall not act to prevent or delay conversion pursuant to this Section 10A.

(c) The Corporation shall deliver to the Transfer Agent irrevocable written instructions authorizing the Transfer Agent, on behalf and at the expense of the Corporation, to cause the Reorganization Conversion Notice to be duly mailed as soon as practicable after receipt of such irrevocable instructions from the Corporation and in accordance with the above provisions. The consideration issuable in the Reorganization Event with respect to shares of Common Stock to be issued upon conversion of the Convertible Preferred Stock pursuant to this Section 10A and all funds necessary for the payment in cash of an amount as calculated in Section 10A(a) shall be deposited with the Transfer Agent in trust at least one Business Day prior to the Reorganization Conversion Date, for the pro rata benefit of the Holders of record as they appear on the stock register of the Corporation, so as to be and continue to be available therefor. Neither failure to mail such Reorganization Conversion Notice to one or more such Holders nor any defect in such Reorganization Conversion Notice shall affect the sufficiency of the proceedings for conversion as to other Holders.

(d) If a Reorganization Conversion Notice shall have been given as hereinbefore provided, then each Holder shall be entitled to all preferences and relative, participating, optional and other special rights accorded by this Certificate of Incorporation until immediately prior to the closing of the Reorganization Event. If the Corporation has complied with Section 10A(c), from and after the closing of the Reorganization Event, the Convertible Preferred Stock shall no longer be deemed to be outstanding, and all rights of such Holders shall cease and terminate, except the right of the Holders, upon surrender of certificates therefor, to receive such cash, securities or other property as are issuable with respect to shares of Common Stock in the Make-Whole Acquisition and any other amounts to be paid hereunder.

(e) The deposit of monies in trust with the Transfer Agent up to the amount necessary for the Mandatory Reorganization Conversion shall be irrevocable except that the Corporation shall be entitled to receive from the Transfer Agent the interest or other earnings, if any, earned on any monies so deposited in trust, and the Holders of the shares converted shall have no claim to such interest or other earnings, and any balance of monies so deposited by the Corporation and unclaimed by the Holders entitled thereto at the expiration of two years from the Reorganization Conversion Date shall be repaid, together with any interest or other earnings thereon, to the Corporation, and after any such repayment, the Holders of the shares entitled to the funds so repaid to the Corporation shall look only to the Corporation for such payment without interest.

(11) **Conversion Procedures.**

(a) Effective immediately prior to the close of business on the Mandatory Conversion Date, the Provisional Conversion Date, the Make-Whole Acquisition Conversion Date, the Reorganization Conversion Date or any Early Conversion Date (collectively, a "CONVERSION DATE"), dividends on any shares of Convertible Preferred Stock converted to Common Stock and/or cash, securities or other property shall cease to accrue and cumulate, and such shares of Convertible Preferred Stock shall cease to be outstanding, in each case, subject to the right of Holders of such shares to receive any accrued, cumulated and unpaid dividends on such shares and any other payments to which they are otherwise entitled pursuant to Section (7), (8), (9), (10) or (10A) hereof, as applicable.

(b) The person or persons entitled to receive the Common Stock and/or cash, securities or other property issuable upon such conversion shall be treated for all purposes as the record holder(s) of such shares of Common Stock and/or securities as of the close of business on the Mandatory Conversion Date, the Make-Whole Acquisition Conversion Date, the Provisional Conversion Date, the Reorganization Conversion Date or any Early Conversion Date, as the case may be. No allowance or adjustment, except as set forth in Section 14, shall be made in respect of dividends payable to holders of Common Stock of record as of any date prior to such effective date. Prior to such effective date, shares of Common Stock issuable upon conversion of, or other securities issuable upon conversion of, any shares of Convertible Preferred Stock shall not be deemed outstanding for any purpose, and Holders of shares of Convertible Preferred Stock shall have no rights with respect to the Common Stock or other securities issuable upon conversion (including voting rights, rights to respond to tender offers for the Common Stock or other securities issuable upon conversion and rights to receive any dividends or other distributions on the Common Stock or other securities issuable upon conversion) by virtue of holding shares of Convertible Preferred Stock.

(c) Shares of Convertible Preferred Stock duly converted in accordance with this Certificate of Incorporation, or otherwise reacquired by the Corporation, will resume the status of authorized and unissued Preferred Stock, undesignated as to series and available for future issuance.

(d) In the event that a Holder of shares of Convertible Preferred Stock shall not by written notice designate the name in which shares of Common Stock to be issued upon conversion of such shares should be registered or the address to which the certificate or certificates representing such shares should be sent, the Corporation shall be entitled to register such shares, and make such payment, in the name of the Holder of such Convertible Preferred Stock as shown on the records of the Corporation and to send the certificate or certificates representing such shares to the address of such Holder shown on the records of the Corporation.

(12) **Reservation of Common Stock.**

(a) The Corporation shall at all times reserve and keep available out of its authorized and unissued Common Stock or shares held in the treasury of the Corporation, solely for issuance upon the conversion of shares of Convertible Preferred Stock as herein provided, free from any preemptive or other similar rights, such number of shares of Common Stock as shall from time to time be issuable upon the conversion of all the shares of Convertible Preferred Stock then outstanding. For purposes of this Section 12(a), the number of shares of Common Stock that shall be deliverable upon the conversion of all outstanding shares of Convertible Preferred Stock shall be computed as if at the time of computation all such outstanding shares were held by a single Holder.

(b) Notwithstanding the foregoing, the Corporation shall be entitled to deliver upon conversion of shares of Convertible Preferred Stock, as herein provided, shares of Common Stock reacquired and held in the treasury of the Corporation (in lieu of the issuance of authorized and unissued shares of Common Stock), so long as any such treasury shares are free and clear of all liens, charges, security interests or encumbrances (other than liens, charges, security interests and other encumbrances created by the Holders).

(c) All shares of Common Stock delivered upon conversion of the Convertible Preferred Stock shall be duly authorized, validly issued, fully paid and non-assessable, free and clear of all liens, claims, security interests and other encumbrances (other than liens, charges, security interests and other encumbrances created by the Holders).

(d) Prior to the delivery of any securities that the Corporation shall be obligated to deliver upon conversion of the Convertible Preferred Stock, the Corporation shall use its reasonable best efforts to comply with all federal and state laws and regulations thereunder requiring the registration of such securities with, or any approval of or consent to the delivery thereof by, any governmental authority.

(e) The Corporation hereby covenants and agrees that, if at any time the Common Stock shall be listed on the New York Stock Exchange or any other national securities exchange or automated quotation system, the Corporation will, if permitted by the rules of such exchange or automated quotation system, list and keep listed, so long as the Common Stock shall be so listed on such exchange or automated quotation system, all Common Stock issuable upon conversion of the Convertible Preferred Stock; PROVIDED, HOWEVER, that if the rules of such exchange or automated quotation system permit the Corporation to defer the listing of such Common Stock until the first conversion of Convertible Preferred Stock into Common Stock in accordance with the provisions hereof, the Corporation covenants to list such Common Stock issuable upon conversion of the Convertible Preferred Stock in accordance with the requirements of such exchange or automated quotation system at such time.

(13) **Fractional Shares.**

(a) No fractional shares of Common Stock will be issued as a result of any conversion of shares of Convertible Preferred Stock.

(b) In lieu of any fractional share of Common Stock otherwise issuable in respect of any mandatory conversion pursuant to Section 7 hereof, any conversion at the option of the Corporation pursuant to Section 9 or Section 10A hereof or a conversion at the option of the holder pursuant to Section 8 or Section 10 hereof, the Corporation shall pay an amount in cash (computed to the nearest cent) equal to the same fraction of:

(i) in the case of a conversion pursuant to Section 7 or Section 9 hereof, a Make-Whole Acquisition Conversion pursuant to Section 10, or a Mandatory Reorganization Conversion pursuant to Section 10A, the Current Market Price; or

(ii) in the case of an Early Conversion pursuant to Section 8 hereof, the Closing Price of the Common Stock determined as of the second Trading Day immediately preceding the effective date of conversion.

(c) If more than one share of the Convertible Preferred Stock is surrendered for conversion at one time by or for the same Holder, the number of full shares of Common Stock issuable upon conversion thereof shall be computed on the basis of the aggregate number of shares of the Convertible Preferred Stock so surrendered.

(14) **Anti-Dilution Adjustments to the Fixed Conversion Rates.**

(a) *Anti-Dilution Adjustments*. Each Fixed Conversion Rate and the number of shares of Common Stock to be delivered upon conversion shall be subject to the following adjustments.

(i) *Stock Dividends and Distributions*. If the Corporation shall pay or make a dividend or other distribution on the Common Stock in shares of Common Stock, each Fixed Conversion Rate, as in effect at the opening of business on the day following the date fixed for the determination of shareholders entitled to receive such dividend or other distribution, shall be increased by dividing such Fixed Conversion Rate by a fraction of which the numerator shall be the number of shares of Common Stock outstanding at the close of business on the date fixed for such determination and the denominator shall be the sum of such number of shares of Common Stock outstanding and the total number of shares of Common Stock constituting such dividend or other distribution, such increase to become effective immediately after the opening of business on the day following the date fixed for such determination. For the purposes of this sub-section (i), the number of shares of Common Stock at the time outstanding shall not include shares held in the treasury of the Corporation but shall include any shares issuable in respect of any scrip certificates issued in lieu of fractions of shares of Common Stock. The Corporation will not pay any dividend or make any distribution on shares of Common Stock held in the treasury of the Corporation.

(ii) *Subdivisions, Splits and Combinations of the Common Stock*. In case outstanding shares of Common Stock shall be subdivided or split into a greater number of shares of Common Stock, each Fixed Conversion Rate in effect at the opening of business on the day following the day upon which such subdivision or split becomes effective shall be proportionately increased, and, conversely, in case outstanding shares of Common Stock shall each be combined into a smaller number of shares of Common Stock, such Fixed Conversion Rate in effect at the opening of business on the day following the day upon which such combination becomes effective shall be proportionately reduced, such increase or reduction, as the case may be, to become effective immediately after the opening of business on the day following the day upon which such subdivision, split or combination becomes effective.

(iii) *Issuance of Stock Purchase Rights*. In case the Corporation shall issue rights or warrants to all holders of its Common Stock (other than rights or warrants issued pursuant to a dividend reinvestment plan or share purchase plan or other similar plans), entitling such holders, for a period of up to 45 days from the date of issuance of such rights or warrants, to subscribe for or purchase shares of Common Stock at a price per share less than the

Current Market Price on the date fixed for the determination of shareholders entitled to receive such rights or warrants, each Fixed Conversion Rate in effect at the opening of business on the day following the date fixed for such determination shall be increased by multiplying such Fixed Conversion Rate by a fraction, the numerator of which shall be the number of shares of Common Stock outstanding at the close of business on the date fixed for such determination plus the number of shares of Common Stock so offered for subscription or purchase and the denominator of which shall be the number of shares of Common Stock outstanding at the close of business on the date fixed for such determination plus the number of shares of Common Stock which the aggregate offering price of the total number of shares of Common Stock so offered for subscription or purchase would purchase at such Current Market Price, such increase to become effective immediately after the opening of business on the day following the date fixed for such determination. For the purposes of this clause (iii), the number of shares of Common Stock at any time outstanding shall not include shares held in the treasury of the Corporation but shall include any shares issuable in respect of any scrip certificates issued in lieu of fractions of shares of Common Stock. The Corporation shall not issue any such rights or warrants in respect of shares of Common Stock held in the treasury of the Corporation.

(iv) *Debt or Asset Distribution.*

(A) If the Corporation shall, by dividend or otherwise, distribute to all holders of its Common Stock evidences of its indebtedness, shares of capital stock, securities, cash or other assets (excluding any dividend or distribution referred to in Section 14(a)(i) or Section 14(a)(ii) hereof, any rights or warrants referred to in Section 14(a)(iii) hereof, any dividend or distribution paid exclusively in cash, any consideration payable in connection with a tender or exchange offer made by the Corporation or any subsidiary of the Corporation, and any dividend of shares of capital stock of any class or series, or similar equity interests, of or relating to a subsidiary or other business unit in the case of a Spin-Off referred to in Section 14(a)(iv)(B) below), each Fixed Conversion Rate in effect immediately prior to the close of business on the date fixed for the determination of shareholders entitled to receive such distribution will be increased by multiplying each Fixed Conversion Rate by the following fraction:

$$\frac{SP_0}{SP_0 - FMV}$$

Where,

SP_0 = the Current Market Price per share of Common Stock on the date fixed for distribution.

FMV= the fair market value of the portion of the distribution applicable to one share of Common Stock as determined by the Board,

Any adjustment to the Conversion Rate under this clause (iv)(A) of this Section 14(a) will become effective immediately prior to the opening of business on the day following the date fixed for the determination of shareholders entitled to receive such distribution. In any case in which this clause (iv)(A) is applicable, clause (iv)(B) of this Section 14(a) shall not be applicable.

(B) In the case of a Spin-Off, each Fixed Conversion Rate in effect immediately before the close of business on the record date fixed for determination of shareholders entitled to receive that distribution will be increased by multiplying each Fixed Conversion Rate by the following fraction:

$$\frac{MP_0 + MPs}{MP_0}$$

Where,

MP_0 = the Current Market Price per share of Common Stock on the fifteenth Trading Day after the "ex-date" for the distribution.

MPs= the Current Market Price of the shares representing the portion of distribution applicable to one share of Common Stock on the fifteenth Trading Day after the "ex-date" for the distribution.

Any adjustment to the Conversion Rate under this clause (iv)(B) of this Section 14(a) will occur on the 15th Trading Day from, but excluding, the "ex-date" with respect to the Spin-Off.

(iv) *Cash Distributions*. If the Corporation shall distribute cash to all holders of the Common Stock, excluding (i) any cash that is distributed in a Reorganization Event to which Section 14(e) applies or as part of a distribution referred to in paragraph (iv) of this Section 14(a), (ii) any dividend or distribution in connection with the liquidation, dissolution or winding up of the Corporation, (iii) any consideration payable in connection with a tender or exchange offer made by the Corporation or any subsidiary of the Corporation or (iv) any cash dividends on the Common Stock to the extent that the aggregate cash dividend per share of Common Stock does not exceed $0.065 in any fiscal quarter (such number, the "DIVIDEND THRESHOLD AMOUNT"), then each Fixed Conversion Rate in effect immediately prior to the close of business on the date for determination of the shareholders of the Corporation entitled to receive such distribution shall be increased by multiplying each Fixed Conversion Rate by the following fraction:

$$\frac{SP_0}{SP_0 - DIV}$$

Where,

SP_0 = the Current Market Price per share of Common Stock on the "ex-date".

DIV = the amount per share of Common Stock of the dividend or distribution.

Any adjustment to the Conversion Rate under this clause (v) of this Section 14(a) will become effective immediately prior to the opening of business on the day following the date fixed for the determination of shareholders entitled to receive such distribution.

If an adjustment is required to be made as set forth in this clause (v) as a result of a distribution (1) that is a regularly scheduled quarterly dividend, such adjustment would be based on the amount by which such dividend exceeds the Dividend Threshold Amount or (2) that is not a regularly scheduled quarterly dividend, such adjustment would be based on the full amount of such distribution.

The Dividend Threshold Amount is subject to an inversely proportional adjustment whenever the Fixed Conversion Rates are adjusted, PROVIDED that no adjustment will be made to the Dividend Threshold Amount for any adjustment made to the Fixed Conversion Rates pursuant to this clause (v) or clause (iii), (iv), (vi), (vii) or (viii) of this Section 14(a).

(v) *Self Tender Offers and Exchange Offers.* If the Corporation or any of its subsidiaries successfully complete a tender or exchange offer for Common Stock where the cash and the value of any other consideration included in the payment per share of the Common Stock exceeds the Current Market Price per share of the Common Stock on the seventh Trading Day after the expiration of the tender or exchange offer, then each Fixed Conversion Rate in effect on immediately prior to the opening on business on the eighth Trading Day after the expiration of the tender or exchange offer will be increased by multiplying by the following fraction:

$$\frac{(SP_0 \text{ x } OS_0) - AC}{SP_0 \text{ x } (OS_0 - TS)}$$

Where,

SP_0 = the Current Market Price per share of Common Stock on the seventh Trading Day after the expiration of the tender or exchange offer.

OS_0 = the number of shares of Common Stock outstanding at the expiration of the tender or exchange offer, including any shares validly tendered and not withdrawn.

AC= the aggregate cash and fair market value of the other consideration payable in the tender or exchange offer, as determined by the Board.

TS= the number of shares of Common Stock validly tendered and not withdrawn at the expiration of the tender or exchange offer.

(vi) *Third Party Tender Offers and Exchange Offers.* In case any Person other than the Corporation or any subsidiary of the Corporation makes a payment in respect of a tender offer or exchange offer in which, as of the last time (the "OFFER EXPIRATION TIME") that tenders or exchanges may be made pursuant to such tender or exchange offer (as it may have been amended), the Board is not recommending rejection of the offer, then each Fixed Conversion Rate will be adjusted by multiplying the Fixed Conversion Rate in effect immediately prior to the Offer Expiration Time by the following fraction:

$$\frac{FMV + (OS_1 \text{ x } SP_0)}{OS_0 \text{ x } SP_0}$$

Where,

FMV = the fair market value of the aggregate consideration payable to all holders of the Common Stock based on the acceptance (up to any maximum specified in the terms of the tender or exchange offer) of all shares validly tendered or exchanged and not withdrawn as of the expiration of the offer, as determined by the Board.

OS_1 = the number of shares of Common Stock outstanding immediately prior to the expiration of the offer, less all shares validly tendered or exchanged and not withdrawn as of the expiration of the offer, as determined by the Board.

SP_0 = the Current Market Price per share of Common Stock on the seventh Trading Day after the expiration of the tender or exchange offer.

OS_0 = the number of shares of Common Stock outstanding immediately prior to the expiration of the offer, including any tendered or exchanged shares.

The adjustment referred to in this clause (vii) will only be made if (1) the tender offer or exchange offer is for an amount that increases the offeror's ownership of common stock to more than 30% of the total shares of Common Stock outstanding immediately prior to the Offer Expiration Time; and (2) the cash and Fair Market Value of any other consideration included in the payment per share of Common Stock exceeds the Current Market Price of the Common Stock on the seventh Trading Day next succeeding the Offer Expiration Time.

However, the adjustment referred to in this clause will not be made if as of the Offer Expiration Time, the offering documents disclose a plan or an intention to cause the Corporation to engage in a consolidation or merger or a sale of all or substantially all of the Corporation's assets. In the event the offeror is obligated to purchase shares pursuant to any such tender or exchange offer, but such Person is permanently prevented by applicable law from effecting any such purchases or all such purchases are rescinded, each Fixed Conversion Rate shall be readjusted to what would have been in effect if such tender or exchange offer had not been made.

(vii) *Rights Plans.* To the extent that the Corporation has a rights plan in effect on any Conversion Date, upon conversion of any Convertible Preferred Stock, Holders shall receive, in addition to the Common Stock, the rights under such rights plan, unless, prior to such Conversion Date, the rights have separated from the Common Stock, in which case each Fixed Conversion Rate will be adjusted at the time of separation of such rights as if the Corporation made a distribution to all holders of the Common Stock as described in clause (iv) above, subject to readjustment in the event of the expiration, termination or redemption of such rights.

(b) ***Adjustment for Tax Reasons.*** The Corporation may make such increases in each Fixed Conversion Rate, in addition to any other increases required by this Section 14, if the Board deems it advisable to avoid or diminish any income tax to holders of the Common Stock resulting from any dividend or distribution of shares (or issuance of rights or warrants to acquire shares) or from any event treated as such for income tax purposes or for any other reasons; PROVIDED that the same proportionate adjustment must be made to each Fixed Conversion Rate.

(c) ***Calculation of Adjustments.*** (i) All adjustments to the Conversion Rate shall be calculated to the nearest 1/10,000th of a share (or, if there is not a nearest 1/10,000th of a share, to the next lower 1/10,000th of a share) of Common Stock. Prior to the Mandatory Conversion Date, no adjustment in the Conversion Rate shall be required unless such adjustment would require an increase or decrease of at least one percent therein; PROVIDED, that any adjustments which by reason of this subparagraph are not required to be made shall be carried forward and taken into account in any subsequent adjustment; PROVIDED FURTHER that on the earliest of the Mandatory Conversion Date, the Provisional Conversion Date, the Make-Whole Acquisition Conversion Date and the Reorganization Conversion Date, adjustments to the Conversion Rate will be made with respect to any such adjustment carried forward and which has not been taken into account before such date. If an adjustment is made to the Conversion Rate pursuant to Sections 14(a)(i), 14(a)(ii), 14(a)(iii), 14(a)(iv), 14(a)(v), 14(a)(vi), 14(a)(vii) or 14(b), an inversely proportional adjustment shall also be made to the Threshold Appreciation Price and the Initial Price solely for purposes of determining which of clauses (i), (ii) and (iii) of Section 7(b) will apply on the Conversion Date. Such adjustment shall be made by dividing each of the Threshold Appreciation Price and the Initial Price by a fraction, the numerator of which shall be the Conversion Rate immediately after such adjustment pursuant to Sections 14(a)(i), 14(a)(ii), 14(a)(iii), 14(a)(iv), 14(a)(v), 14(a)(vi) or 14(a)(vii) or 14(b) and the denominator of which shall be the Conversion Rate immediately before such adjustment.

(i) No adjustment to the Conversion Rate need be made if Holders may participate, on an as-converted basis, in the transaction that would otherwise give rise to an adjustment, so long as the distributed assets or securities the Holders would receive upon conversion of the Convertible Preferred Stock, if convertible, exchangeable, or exercisable, are convertible, exchangeable or exercisable, as applicable, without any loss of rights or privileges for a period of at least 45 days following conversion of the Convertible Preferred Stock. The applicable Conversion Rate shall not be adjusted:

(A) upon the issuance of any shares of the Common Stock pursuant to any present or future plan providing for the reinvestment of dividends or interest payable on the Corporation's securities and the investment of additional optional amounts in shares of Common Stock under any plan;

(B) upon the issuance of any shares of the Common Stock or rights or warrants to purchase those shares pursuant to any present or future employee, director or consultant benefit plan or program of or assumed by the Corporation or any of its subsidiaries;

(C) upon the issuance of any shares of the Common Stock pursuant to any option, warrant, right or exercisable, exchangeable or convertible security outstanding as of the date shares of the Convertible Preferred Stock were first issued;

(D) for a change in the par value or no par value of the Common Stock; or

(E) for accrued, cumulated and unpaid dividends.

(ii) The Corporation shall have the power to resolve any ambiguity or correct any error in this Section 14 and its action in so doing, as evidenced by a resolution of the Board, or a duly authorized committee thereof, shall be final and conclusive.

(d) *Notice of Adjustment.* Whenever each Fixed Conversion Rate is to be adjusted in accordance with Section 14(a) or (b), the Corporation shall: (i) compute each Fixed Conversion Rate in accordance with Section 14(a) or (b) and prepare and transmit to the Transfer Agent an Officer's Certificate setting forth each Fixed Conversion Rate, the method of calculation thereof in reasonable detail, and the facts requiring such adjustment and upon which such adjustment is based; (ii) as soon as practicable following the occurrence of an event that requires an adjustment to each Fixed Conversion Rate pursuant to Section 14(a) or (b), taking into account the one percent threshold set forth in Section 14(c) hereof, (or if the Corporation is not aware of such occurrence, as soon as practicable after becoming so aware), provide, or cause to be provided, a written notice to the Holders of the Convertible Preferred Stock of the occurrence of such event; and (iii) as soon as practicable following the determination of each revised Fixed Conversion Rate in accordance with Section 14(a) or (b) hereof, a statement setting forth in reasonable detail the method by which the adjustment to each Fixed Conversion Rate was determined and setting forth each revised Fixed Conversion Rate.

(e) Reorganization Events. In the event of:

(i) any consolidation or merger of the Corporation with or into another Person (other than a merger or consolidation in which the Corporation is the continuing corporation and in which the Common Stock outstanding immediately prior to the merger or consolidation is not exchanged for cash, securities or other property of the Corporation or another Person);

(ii) any sale, transfer, lease or conveyance to another Person of all or substantially all of the property and assets of the Corporation;

(iii) any reclassification of Common Stock into securities including securities other than Common Stock; or

(iv) any statutory exchange of securities of the Corporation with another Person (other than in connection with a merger or acquisition) (any such event specified in this Section 14(e), a "REORGANIZATION EVENT");

each share of Convertible Preferred Stock outstanding immediately prior to such Reorganization Event shall, after such Reorganization Event, be convertible into the kind of securities, cash and other property receivable in such Reorganization Event (without any interest thereon and without any right to dividends or distribution thereon which have a record date that is prior to the Conversion Date) (the "EXCHANGE PROPERTY") by a holder of Common Stock that (1) is not a person with which the Corporation consolidated or into which the Corporation merged or which merged into the Corporation or to which such sale or transfer was made, as the case may be (any such person, a "CONSTITUENT PERSON"), or an Affiliate of a Constituent Person, and (2) failed to exercise his rights of election, if any, as to the kind or amount of securities, cash and other property receivable upon such Reorganization Event (PROVIDED that if the kind or amount of securities, cash and other property receivable upon such Reorganization Event is not the same for each share of Common Stock held immediately prior to such Reorganization Event by other than a Constituent Person or an Affiliate thereof and in respect of which such rights of election shall not have been exercised ("NON-ELECTING SHARE"), then, for the purpose of this Section 14(e) the kind and amount of securities, cash and other property receivable upon such Reorganization Event by each Non-electing Share shall be deemed to be the kind and amount so receivable per share by a plurality of the Non-electing Shares). The amount of Exchange Property receivable upon conversion of any Convertible Preferred Stock in accordance with Section 7, 8, 9, 10 or 10A hereof shall be determined based upon the Conversion Rate in effect on such Conversion Date. The applicable Conversion Rate shall be (x) the Minimum Conversion Rate, in the case of an Early Conversion Date or a Provisional Conversion Date, and (y) determined based upon the definition of Conversion Rate set forth in Sections 7, 10 or 10A, in the case of the Mandatory Conversion Date, the Make-Whole Acquisition Conversion Date, or the Reorganization Conversion Date, respectively.

After a Reorganization Event, "APPLICABLE MARKET VALUE" shall be deemed to refer to the Applicable Market Value of the Exchange Property and such value shall be determined (A) with respect to any publicly traded securities that compose all or part of the Exchange Property, the average of the Closing Prices of such securities on each of the 20 consecutive Trading Days ending on the third Trading Day immediately preceding the Mandatory Conversion Date, (B) in the case of any cash that composes all or part of the Exchange Property, based on the amount of such cash and (C) in the case of any other property that composes all or part of the Exchange Property, based on the value of such property on the Third Trading Day immediately preceding the Mandatory Conversion Date, as determined by a nationally recognized independent investment banking firm retained by the Corporation for this purpose. For purposes of this Section 14(e), the term "CLOSING PRICE" shall be deemed to refer to the closing sale price, last quoted bid price or mid-point of the last bid and ask prices, as the case may be, of any publicly traded securities that comprise all or part of the Exchange Property. For purposes of this Section 14(e), references to Common Stock in the definition of "TRADING DAY" shall be replaced by references to any publicly traded securities that comprise all or part of the Exchange Property.

The above provisions of this Section 14(e) shall similarly apply to successive Reorganization Events and the provisions of Section 14 shall apply to any shares of capital stock of the Corporation (or any successor) received by the holders of Common Stock in any such Reorganization Event.

The Corporation (or any successor) shall, within 20 days of the occurrence of any Reorganization Event, provide written notice to the Holders of such occurrence of such event and of the kind and amount of the cash, securities or other property that constitutes the Exchange Property. Failure to deliver such notice shall not affect the operation of this Section 14(e).

(f) *Adjustment of Make-Whole Acquisition Stock Prices.* The Make-Whole Acquisition Stock Prices appearing in the column headings for the table included in the definition of Make-Whole Acquisition Conversion Rate in Section 19 hereof shall be adjusted as of any date on which the Fixed Conversion Rates are adjusted. The adjusted Make-Whole Acquisition Stock Prices will equal the Make-Whole Acquisition Stock Prices applicable immediately prior to such adjustment multiplied by a fraction, the numerator of which is the Minimum Conversion Rate immediately prior to the adjustment and the denominator of which is the Minimum Conversion Rate as so adjusted. In addition, each of the Make-Whole Acquisition Stock Prices appearing in such table will be subject to adjustment in the same manner as each Fixed Conversion Rate is adjusted in accordance with the terms of this Section 14.

(15) **Replacement Stock Certificates.**

(a) If physical certificates are issued, and any of the Convertible Preferred Stock certificates shall be mutilated, lost, stolen or destroyed, the Corporation shall, at the expense of the Holder, issue, in exchange and in substitution for and upon cancellation of the mutilated Convertible Preferred Stock certificate, or in lieu of and substitution for the Convertible Preferred Stock certificate lost, stolen or destroyed, a new Convertible Preferred Stock certificate of like tenor and representing an equivalent amount of shares of Convertible Preferred Stock, but only upon receipt of evidence of such loss, theft or destruction of such Convertible Preferred Stock certificate and indemnity, if requested, satisfactory to the Corporation and the Transfer Agent.

(b) The Corporation is not required to issue any certificates representing the Convertible Preferred Stock on or after the Mandatory Conversion Date, any Provisional Conversion Date or any Reorganization Conversion Date. In lieu of the delivery of a replacement certificate following the Mandatory Conversion Date, any Provisional Conversion Date or any Reorganization Conversion Date, the Transfer Agent, upon delivery of the evidence and indemnity described above, will deliver the shares of Common Stock or cash, securities or other property issuable pursuant to the terms of the Convertible Preferred Stock formerly evidenced by the certificate.

(16) **Transfer Agent, Registrar, Paying Agent and Conversion Agent.** The duly appointed Transfer Agent, Registrar, paying agent and conversion agent for the Convertible Preferred Stock shall be Wells Fargo Shareowner Services. The Corporation may, in its sole discretion, remove the Transfer Agent in accordance with the agreement between the Corporation and the Transfer Agent; PROVIDED that the Corporation shall appoint a successor transfer agent who shall accept such appointment prior to the effectiveness of such removal. Upon any such removal or appointment, the Corporation shall send notice thereof by first-class mail, postage prepaid, to the Holders of the Convertible Preferred Stock.

(17) **Form.**

(a) Convertible Preferred Stock shall be issued in the form of one or more permanent global shares of Convertible Preferred Stock in definitive, fully registered form with the global legend (the "GLOBAL SHARES LEGEND"), as set forth on the form of Convertible Preferred Stock certificate attached hereto as Exhibit A (each, a "GLOBAL PREFERRED SHARE"), which is hereby incorporated in and expressly made a part of this Certificate of Incorporation. The Global Preferred Share may have notations, legends or endorsements required by law, stock exchange rules, agreements to which the Corporation is subject, if any, or usage (PROVIDED that any such notation, legend or endorsement is in a form acceptable to the Corporation). The Global Preferred Share shall be deposited on behalf of the holders of the Convertible Preferred Stock represented thereby with the Registrar, at its New York office, as custodian for DTC or a Depositary, and registered in the name of the Depositary or a nominee of the Depositary, duly executed by the Corporation and countersigned and registered by the Registrar as hereinafter provided. The aggregate number of shares represented by each Global Preferred Share may from time to time be increased or decreased by adjustments made on the records of the Registrar and the Depositary or its nominee as hereinafter provided. This Section 17(a) shall apply only to a Global Preferred Share deposited with or on behalf of the Depositary. The Corporation shall execute and the Registrar shall, in accordance with this Section, countersign and deliver initially one or more Global Preferred Shares that (i) shall be registered in the name of Cede & Co. or other nominee of the Depositary and (ii) shall be delivered by the Registrar to Cede & Co. or pursuant to instructions received from Cede & Co. or held by the Registrar as custodian for the Depositary pursuant to an agreement between the Depositary and the Registrar. Members of, or participants in, the Depositary ("AGENT MEMBERS") shall have no rights under this Certificate with respect to any Global Preferred Share held on their behalf by the Depositary or by the Registrar as the custodian of the Depositary or under such Global Preferred Share, and the Depositary may be treated by the Corporation, the Registrar and any agent of the Corporation or the Registrar as the absolute owner of such Global Preferred Share for all purposes whatsoever. Notwithstanding the foregoing, nothing herein shall prevent the Corporation, the Registrar or any agent of the Corporation or the Registrar from giving effect to any written certification, proxy or other authorization furnished by the Depositary or impair, as between the Depositary and its Agent Members, the operation of customary practices of the Depositary governing the exercise of the rights of a holder of a beneficial interest in any Global Preferred Share. The Holder of the Convertible Preferred Shares may grant proxies or otherwise authorize any Person to take any action that a Holder is entitled to take pursuant to the Convertible Preferred Shares or this Certificate of Incorporation. Owners of beneficial interests in Global Preferred Shares shall not be entitled to receive physical delivery of certificated shares of Convertible Preferred Stock, unless (x) the Depositary is unwilling or unable to continue as Depositary for the Global Preferred Share and the Corporation does not appoint a qualified replacement for the Depositary within 90 days, (y) the Depositary ceases to be a "clearing agency" registered under the Exchange Act and the Corporation does not appoint a qualified replacement for the Depositary within 90 days or (z) the Corporation decides to discontinue the use of book-entry transfer through the Depositary. In any such case, the Global Preferred Share shall be exchanged in whole for definitive shares of Convertible Preferred Stock in registered form, with the same terms and of an equal aggregate Liquidation Preference. Definitive shares of Convertible Preferred Stock shall be registered in the name or names of the Person or Persons specified by the Depositary in a written instrument to the Registrar.

(b) (i) An Officer shall sign the Global Preferred Share for the Corporation, in accordance with the Corporation's bylaws and applicable law, by manual or facsimile signature.

(ii) If an Officer whose signature is on a Global Preferred Share no longer holds that office at the time the Transfer Agent countersigned the Global Preferred Share, the Global Preferred Share shall be valid nevertheless.

(iii) A Global Preferred Share shall not be valid until an authorized signatory of the Transfer Agent manually countersigns Global Preferred Share. Each Global Preferred Share shall be dated the date of its countersignature.

(18) **Miscellaneous.**

(a) All notices referred to herein shall be in writing, and, unless otherwise specified herein, all notices hereunder shall be deemed to have been given upon the earlier of receipt thereof or three Business Days after the mailing thereof if sent by registered or certified mail (unless first-class mail shall be specifically permitted for such notice under the terms of this Certificate of Incorporation) with postage prepaid, addressed: (i) if to the Corporation, to its office at One Merck Drive, Whitehouse Station, NJ 08889 (Attention: the Secretary) or to the Transfer Agent at its Corporate Trust Office, or other agent of the Corporation designated as permitted by this Certificate of Incorporation, or (ii) if to any Holder of the Convertible Preferred Stock or holder of shares of Common Stock, as the case may be, to such Holder at the address of such Holder as listed in the stock record books of the Corporation (which may include the records of any transfer agent for the Convertible Preferred Stock or Common Stock, as the case may be), or (iii) to such other address as the Corporation or any such Holder, as the case may be, shall have designated by notice similarly given.

(b) The Corporation shall pay any and all stock transfer and documentary stamp taxes that may be payable in respect of any issuance or delivery of shares of Convertible Preferred Stock or shares of Common Stock or other securities issued on account of Convertible Preferred Stock pursuant hereto or certificates representing such shares or securities. The Corporation shall not, however, be required to pay any such tax that may be payable in respect of any transfer involved in the issuance or delivery of shares of Convertible Preferred Stock or Common Stock or other securities in a name other than that in which the shares of Convertible Preferred Stock with respect to which such shares or other securities are issued or delivered were registered, or in respect of any payment to any person other than a payment to the registered holder thereof, and shall not be required to make any such issuance, delivery or payment unless and until the person otherwise entitled to such issuance, delivery or payment has paid to the Corporation the amount of any such tax or has established, to the satisfaction of the Corporation, that such tax has been paid or is not payable.

(c) The Liquidation Preference and the dividend amounts set forth herein each shall be subject to equitable adjustment whenever there shall occur a stock split, combination, reclassification or other similar event involving the Convertible Preferred Stock. Such adjustments shall be determined in good faith by the Board and submitted by the Board to the Transfer Agent.

(19) **Definitions.** Unless otherwise defined herein, capitalized terms used in this Annex A shall have the following meanings:

"ACCEPTED PURCHASED SHARES" shall have the meaning set forth in Section 14(a) (vii) hereof.

"AFFILIATE" shall have the meaning given to that term in Rule 405 of the Securities Act of 1933, as amended, or any successor rule thereunder.

"AGENT MEMBERS" shall have the meaning set forth in Section 17(a) hereof.

"APPLICABLE MARKET VALUE" means the average of the Closing Prices per share of the Common Stock on each of the 20 consecutive Trading Days ending on the third Trading Day immediately preceding the Mandatory Conversion Date.

"BOARD" means the Board of Directors of the Corporation.

"BUSINESS DAY" means any day other than a Saturday or Sunday or any other day on which banks in The City of New York are authorized or required by law or executive order to close.

"CERTIFICATE OF INCORPORATION" means the Certificate of Incorporation of the Corporation, as amended.

"CLOSING PRICE" means, as of any date of determination, the closing sale price or, if no closing sale price is reported, the last reported sale price, of the Common Stock or any securities distributed in a Spin-Off, as the case may be, on the New York Stock Exchange on that date. If the Common Stock or any such securities distributed in a Spin-Off, as the case may be, is not then traded on the New York Stock Exchange on any date of determination, the Closing Price of the Common Stock or such securities on any date of determination means the closing sale price as reported in the composite transactions for the principal U.S. national or regional securities exchange on which the Common Stock or such securities is so listed or quoted, or if the Common Stock or such securities is not so listed or quoted on a U.S. national or regional securities exchange, the last quoted bid price for the Common Stock or such securities in the over-the-counter market as reported by the Pink Sheets LLC or similar organization, or, if that bid price is not available, the market price of the Common Stock or such securities on that date as determined by a nationally recognized independent investment banking firm retained for this purpose by the Corporation. For the purposes of this Certificate of Incorporation, all references herein to the closing sale price of the Common Stock on the New York Stock Exchange shall be such closing sale price as reflected on the website of the New York Stock Exchange (www.nyse.com) and as reported by Bloomberg Professional Service; PROVIDED that, in the event that there is a discrepancy between the closing sale price as reflected on the website of the New York Stock Exchange and as reported by Bloomberg Professional Service, the closing sale price on the website of the New York Stock Exchange shall govern.

"COMMON STOCK" as used in this Certificate of Incorporation means the Corporation's Common Shares, par value $0.50 per share, as the same exists at the date of filing of this Certificate of Incorporation, or any other class of stock resulting from successive changes or reclassifications of such Common Shares consisting solely of changes in par value, or from par value to no par value, or from no par value to par value. However, subject to the provisions of Section 14(e), shares of Common Stock issuable on conversion of shares of Convertible Preferred Stock shall include only shares of the class designated as Common Shares of the Corporation at the date of the filing of this Certificate of Incorporation with the Secretary of State of the State of New Jersey or shares of any class or classes resulting from any reclassification or reclassifications thereof and which have no preference in respect of dividends or of amounts payable in the event of any voluntary or involuntary liquidation, dissolution or winding up of the Corporation and which are not subject to redemption by the Corporation; PROVIDED that if at any time there shall be more than one such resulting class, the shares of each such class then so issuable shall be substantially in the proportion which the total number of shares of such class resulting from all such reclassifications bears to the total number of shares of all classes resulting from all such reclassifications.

"CONVERSION DATE" shall have the meaning set forth in Section 11(a) hereof.

"CONVERSION RATE" shall have the meaning set forth in Section 7(b) hereof.

"CONVERTIBLE PREFERRED STOCK" shall have the meaning set forth in Section 1 hereof.

"CORPORATE TRUST OFFICE" means the principal corporate trust office of the Transfer Agent at which, at any particular time, its corporate trust business shall be administered.

"CURRENT MARKET PRICE" per share of Common Stock or other securities on any date means the average of the daily Closing Prices for the five consecutive Trading Days preceding the earlier of the day preceding the date in question and the day before the "ex date" with respect to the issuance or distribution requiring such computation, if applicable. The term "ex date," when used with respect to any issuance or distribution, means the first date on which the Common Stock or other security trades without the right to receive the issuance or distribution. For the purposes of determining the adjustment to the Conversion Rate for the purposes of Section 14(a)(iv)(B) hereof the Current Market Price per share of Common Stock means the average of the Closing Prices over the first ten Trading Days commencing on and including the fifth Trading Day following the "ex-date" for such distribution.

"DEPOSITARY" means DTC or its nominee or any successor appointed by the Corporation.

"DIVIDEND PAYMENT DATE" means (i) the 15th calendar day of February, May, August and November of each year, or the following Business Day if such day is not a Business Day, prior to the Mandatory Conversion Date and (ii) the Mandatory Conversion Date.

"DIVIDEND PERIOD" means the period ending on the day before a Dividend Payment Date and beginning on the preceding Dividend Payment Date or, if there is no preceding Dividend Payment Date, on the first date of issuance of the Convertible Preferred Stock.

"DIVIDEND THRESHOLD AMOUNT" shall have the meaning set forth in Section 14(a)(v) hereof.

"DTC" means The Depository Trust Company.

"EARLY CONVERSION" shall have the meaning set forth in Section 8(a) hereof.

"EARLY CONVERSION DATE" means the effective date of any conversion of Convertible Preferred Stock pursuant to Section 8 hereof.

"EXCHANGE PROPERTY" shall have the meaning set forth in Section 14(e) hereof.

"EXPIRATION TIME" shall have the meaning set forth in Section 14(a)(vi) hereof.

"FAIR MARKET VALUE" means (a) in the case of any Spin-Off, the fair market value of the portion of those shares of capital stock or similar equity interests so distributed applicable to one share of Common Stock as of the fifteenth Trading Day after the "ex-date" for such Spin-Off, and (b) in all other cases the fair market value as determined in good faith by the Board, whose determination shall be conclusive and described in a resolution of the Board.

"FIXED CONVERSION RATES" means the Maximum Conversion Rate and the Minimum Conversion Rate.

"GLOBAL PREFERRED SHARE" shall have the meaning set forth in Section 17(a) hereof.

"GLOBAL SHARES LEGEND" shall have the meaning set forth in Section 17(a) hereof.

"HOLDER" means the person in whose name the shares of the Convertible Preferred Stock are registered, which may be treated by the Corporation and the Transfer Agent as the absolute owner of the shares of Convertible Preferred Stock for the purpose of making payment and settling conversions and for all other purposes.

"INITIAL PRICE" shall have the meaning set forth in Section 7(b) hereof.

"JUNIOR SECURITIES" shall have the meaning set forth in Section 2 hereof.

"LIQUIDATION PREFERENCE" means, as to the Convertible Preferred Stock, $250 per share, as adjusted pursuant to the terms hereof.

"MAKE-WHOLE ACQUISITION" means the consummation of any acquisition (whether by means of a liquidation, share exchange, tender offer, consolidation, recapitalization, reclassification, merger of the Corporation or any sale, lease or other transfer of the consolidated assets of the Corporation and its subsidiaries) or a series of related transactions or events pursuant to which 90% or more of the Corporation's outstanding shares of Common Stock are exchanged for, converted into or constitutes solely the right to receive cash, securities or other property more than 10% of which consists of cash, securities or other property that are not, or upon issuance will not be, shares of common equity or American depositary receipts in respect of common equity traded on the New York Stock Exchange, the Nasdaq Global Select Market or Nasdaq Global Market.

"MAKE-WHOLE ACQUISITION CONVERSION" shall have the meaning set forth in Section 10(a) hereof.

"MAKE-WHOLE ACQUISITION CONVERSION DATE" means the effective date of a Make-Whole Acquisition Conversion of Convertible Preferred Stock pursuant to Section 10 hereof.

"MAKE-WHOLE ACQUISITION CONVERSION NOTICE" shall have the meaning set forth in Section 10(b) hereof.

"MAKE-WHOLE ACQUISITION CONVERSION PERIOD" shall have the meaning set forth in Section 10(a) hereof.

"MAKE-WHOLE ACQUISITION CONVERSION RATE" means the conversion rate set forth in the table below for the applicable effective date of the Make-Whole Acquisition and the applicable Make-Whole Acquisition Stock Price (as Make-Whole Acquisition Stock Prices in the column headings for the table below are adjusted pursuant to Section 14 hereof):

	Stock Price															
Effective Date	**$10.00**	**$15.00**	**$20.00**	**$25.00**	**$27.50**	**$30.00**	**$33.69**	**$35.00**	**$40.00**	**$45.00**	**$50.00**	**$55.00**	**$60.00**	**$65.00**	**$75.00**	**$100.00**
8/15/2007	8.1797	7.9890	7.8360	7.7129	7.6145	7.4869	7.3271	7.2854	7.1930	7.1697	7.1685	7.1673	7.1676	7.1678	7.1681	7.1685
8/15/2008	8.7368	8.6200	8.4101	8.0711	7.8702	7.6758	7.4494	7.3929	7.2777	7.2515	7.2485	7.2488	7.2494	7.2500	7.2503	7.2523
8/15/2009	8.9569	8.9515	8.8654	8.5305	8.2348	7.9071	7.5392	7.4625	7.3432	7.3303	7.3302	7.3309	7.3315	7.3321	7.3329	7.3343
8/13/2010	9.0909	9.0909	9.0909	9.0909	9.0909	8.3333	7.4206	7.4206	7.4206	7.4206	7.4206	7.4206	7.4206	7.4206	7.4206	7.4206

If the Make-Whole Acquisition Stock Price is in excess of $100.00 per share (subject to adjustment pursuant to Section 14 hereof), then the Make-Whole Acquisition Conversion Rate will be the Minimum Conversion Rate (subject to adjustment pursuant to Section 14 hereof). If the Make-Whole Acquisition Share Price is less than $10.00 per share (subject to adjustment pursuant to Section 14 hereof), then the Make-Whole Acquisition Conversion Rate will be the Maximum Conversion Rate (subject to adjustment pursuant to Section 14 hereof).

If the effective date falls between the dates set forth under the heading "Effective Date" in the table above, or if the Make-Whole Acquisition Stock Price falls between two amounts set forth on the table above, the Make-

Whole Acquisition Conversion Rate will be determined by straight-line interpolation between the Make-Whole Acquisition Conversion Rates set forth for the higher and lower Make-Whole Acquisition Stock Prices and effective two dates, based on a 365-day year.

The Make-Whole Acquisition Stock Prices set forth in the table above are subject to adjustment pursuant to Section 14(f) hereof.

"MAKE-WHOLE ACQUISITION STOCK PRICE" means the consideration paid per share of Common Stock in a Make-Whole Acquisition. If such consideration consists only of cash, the Make-Whole Acquisition Stock Price shall equal the amount of cash paid per share. If such consideration consists of any property other than cash, the Make-Whole Acquisition Stock Price shall be the average of the Closing Price per share of Common Stock on each of the 10 consecutive Trading Days up to, but not including, the effective date of the Make-Whole Acquisition.

"MANDATORY CONVERSION DATE" means immediately prior to the close of business on August 13, 2010.

"MANDATORY REORGANIZATION CONVERSION" shall have the meaning set forth in Section 10A(a) hereof.

"MAXIMUM CONVERSION RATE" shall have the meaning set forth in Section 7(b) (iii) hereof.

"MINIMUM CONVERSION RATE" shall have the meaning set forth in Section 7(b)(i) hereof.

"NON-ELECTING SHARE" shall have the meaning set forth in Section 14(e) hereof.

"OFFER EXPIRATION TIME" shall have the meaning set forth in Section 14(a)(vii) hereof.

"OFFICER" means the Chief Executive Officer, the Chief Operating Officer, any Vice President, the Chief Financial Officer, the Treasurer, any Assistant Treasurer, the Secretary or any Assistant Secretary of the Corporation.

"OFFICER'S CERTIFICATE" means a certificate of the Corporation, signed by any duly authorized Officer of the Corporation.

"PARITY SECURITIES" shall have the meaning set forth in Section 2 hereof.

"PERSON" means a legal person, including any individual, corporation, estate, partnership, joint venture, association, joint-stock company, limited liability company or trust.

"PREFERRED STOCK DIRECTOR" shall have the meaning set forth in Section 5(c) hereof.

"PROVISIONAL CONVERSION" shall have the meaning set forth in Section 9(a) hereof.

"PROVISIONAL CONVERSION DATE" means the date fixed for conversion of shares of Convertible Preferred Stock into shares of Common Stock pursuant to Section 9 hereof.

"PROVISIONAL CONVERSION NOTICE" shall have the meaning set forth in Section 9(b) hereof.

"PROVISIONAL CONVERSION NOTICE DATE" shall have the meaning set forth in Section 9(a) hereof.

"PURCHASED SHARES" shall have the meaning set forth in Section 14(a)(vi) hereof.

"RECORD DATE" means the first Business Day of the calendar month in which the applicable Dividend Payment Date falls.

"RECORD HOLDER" means the Holder of record of the Convertible Preferred Stock as they appear on the stock register of the Corporation at the close of business on a Record Date.

"REGISTRAR" shall mean the Transfer Agent acting in its capacity as registrar for the Convertible Preferred Stock, and its successors and assigns.

"REORGANIZATION CONVERSION DATE" shall have the meaning set forth in Section 10A(a) hereof.

"REORGANIZATION CONVERSION NOTICE" shall have the meaning set forth in Section 10A(b) hereof.

"REORGANIZATION CONVERSION NOTICE DATE" shall have the meaning set forth in Section 10A(b) hereof.

"REORGANIZATION EVENT" shall have the meaning set forth in Section 14(e) hereof.

"SENIOR SECURITIES" shall have the meaning set forth in Section 2 hereof.

"SPIN-OFF" means a dividend or other distribution of shares of capital stock of any class or series, or similar equity interests, of or relating to a subsidiary or other business unit of the Corporation.

"THRESHOLD APPRECIATION PRICE" shall have the meaning set forth in Section 7(b) hereof.

"TRADING DAY" means a day on which the Common Stock:

1. is not suspended from trading on any national or regional securities exchange or association or over-the-counter market at the close of business; and

2. has traded at least once on the national or regional securities exchange or association or over-the-counter market that is the primary market for the trading of the Common Stock.

"TRANSFER AGENT" means Wells Fargo Shareowner Services acting as transfer agent, Registrar, paying agent and conversion agent for the Convertible Preferred Stock, and its successors and assigns.

"TREASURY YIELD" means the yield to maturity at the time of computation of U.S. Treasury securities with a constant maturity (as compiled and published in the most recent Federal Reserve Statistical Release H.15 (519) that has become publicly available at least two Business Days prior to the Provisional Conversion Date (or, if such Statistical Release is no longer published, any publicly available source for similar market data)) most nearly equal to the then remaining term through and including the Mandatory Conversion Date; PROVIDED, HOWEVER, that if the then remaining term through and including the Mandatory Conversion Date is not equal to the constant maturity of a U.S. Treasury security for which a weekly average yield is given, the Treasury Yield shall be obtained by linear interpolation (calculated to the nearest one-twelfth of a year) from the weekly average yields of U.S. Treasury securities for which such yields are given, except that if the then remaining term through and including the Mandatory Conversion Date is less than one year, the weekly average yield on actually traded U.S. Treasury securities adjusted to a constant maturity of one year shall be used.

STATE OF NEW JERSEY
DEPARTMENT OF TREASURY
FILING CERTIFICATION (CERTIFIED COPY)

MERCK & CO., INC.

I, the Treasurer of the State of New Jersey, do hereby certify, that the above named business did file and record in this department the below listed document(s) and that the foregoing is a true copy of the Certificate of Restated Incorporation Filed in this office on November 2nd, 2009 as the same is taken from and compared with the original(s) filed in this office on the date set forth on each instrument and now remaining on file and of record in my office.

IN TESTIMONY WHEREOF, I have hereunto set my hand and affixed my Official Seal at Trenton, this 2nd day of November, 2009

R. David Rousseau
State Treasurer

Certificate Number: 115657779
Verify this certificate online at
https://www1.state.nj.us/TYTR_StandingCert/JSP/Verify_Cert.jsp

FILED

NOV 02 2009

STATE TREASURER

CERTIFICATE OF ADOPTION
OF
RESTATED CERTIFICATE OF INCORPORATION
OF
MERCK & CO., INC.
(ID Number: 5934701000)

Merck & Co., Inc., a corporation organized and existing under the laws of the State of New Jersey (the "Corporation"), to amend and restate its Certificate of Incorporation pursuant to Section 14A:9-5 of the New Jersey Business Corporation Act (the "NJBCA"), hereby certifies as follows:

FIRST: The name of the Corporation is Merck Sharp & Dohme Corp.

SECOND: The Restated Certificate of Incorporation attached hereto (the "Restated Certificate") was adopted by the shareholders of the Corporation on August 7, 2009 as part of their approval of the Agreement and Plan of Merger, dated as of March 8, 2009, by and among the Corporation, Schering-Plough Corporation, SP Merger Subsidiary One, Inc. (formerly known as Blue, Inc.), and SP Merger Subsidiary Two, Inc. (formerly known as Purple, Inc.), and pursuant to Section 14A:10-1 and Section 14A:10-4.1 of the NJBCA.

THIRD: The number of shares entitled to vote on the adoption of the Restated Certificate was 2,108,780,449 shares of Common Stock, of which 1,399,114,521 voted for the Restated Certificate as part of their approval of the Agreement and Plan of Merger, and 5,686,148 voted against the Restated Certificate. No shares of any class or series were entitled to vote thereon as a class.

FOURTH: This Certificate of Adoption shall become effective on November 3, 2009 at 4:02 p.m.

IN WITNESS WHEREOF, the Corporation has caused this Certificate to be duly executed as of the 2nd day of November, 2009.

MERCK & CO., INC.

By: Celia A Colbert
Name: Celia A. Colbert
Title: Senior Vice President, Secretary and Assistant General Counsel

RESTATED CERTIFICATE OF INCORPORATION

OF

MERCK & CO., INC.
(ID Number: 5934701000)

Merck & Co., Inc., a corporation organized and existing under the laws of the State of New Jersey (the "Corporation"), restates and integrates its Restated Certificate of Incorporation, as heretofore amended, and also substantively amends such Restated Certificate of Incorporation, to read in full as herein set forth:

FIRST: The name of the Corporation is Merck Sharp & Dohme Corp.

SECOND: The purpose for which the Corporation is organized is to engage in any activity within the purposes for which corporations may be organized under the New Jersey Business Corporation Act.

THIRD: The total number of shares of capital stock which the Corporation shall have authority to issue is 100 shares of common stock, $0.01 par value per share. Shares of capital stock of the Corporation may be issued by the Corporation from time to time for such legally sufficient consideration as may be fixed from time to time by the Board of Directors.

FOURTH: In furtherance and not in limitation of the general powers conferred by the laws of the State of New Jersey, the Board of Directors is expressly authorized to make, alter or repeal the bylaws of the Corporation, except as specifically stated therein.

FIFTH: The Corporation reserves the right to amend, alter, change or repeal any provision contained in the Certificate of Incorporation, in the manner now or hereafter prescribed by statute, and all rights conferred upon shareholders herein are granted subject to this reservation.

SIXTH: The Corporation shall, to the full extent permitted by the New Jersey Business Corporation Act, as it may be amended from time to time, indemnify all persons whom it may indemnify pursuant thereto.

SEVENTH: No director or officer of the Corporation shall be personally liable to the Corporation or its shareholders for damages for breach of any duty owed to the Corporation or its shareholders, except that such provision shall not relieve a director or officer from liability for any breach of duty based upon an act or omission (a) in breach of such person's duty of loyalty to the Corporation or its shareholders, (b) not in good faith or involving a knowing violation of law or (c) resulting in receipt by such person of any improper personal benefit. As used in this article, an act or omission in breach of a person's duty of loyalty means an act or omission which that person knows or believes to be contrary to the best interests of the Corporation or its shareholders in connection with a matter in which he has a material conflict of interest.

EIGHTH: Except as otherwise required by the laws of the State of New Jersey, the shareholders and directors shall have the power to hold their meetings and to keep the books, documents, and papers of the Corporation outside of the State of New Jersey, and the Corporation shall have the power to have one or more offices within or without the State of New Jersey, at such places as may be from time to time designated by the bylaws or by resolution of the shareholders or directors. Elections of directors need not be by ballot unless the bylaws of the Corporation shall so provide.

NINTH: The address of the Corporation's current registered office in the State of New Jersey is 820 Bear Tavern Road, City of West Trenton, County of Mercer, State of New Jersey, 08628, and the name of the Corporation's registered agent at such address is The Corporation Trust Company.

TENTH: The number of directors constituting the current Board of Directors of the Corporation is fifteen (15). The names and addresses of said directors are as follows:

Leslie A. Brun	435 Devon Park Drive, 700 Building Wayne, Pennsylvania 19087
Thomas R. Cech, Ph.D.	University of Colorado, Boulder Boulder, Colorado 80309-0215
Richard T. Clark	One Merck Drive Whitehouse Station, New Jersey 08889-0100
Thomas H. Glocer	3 Times Square, 30th Floor New York, New York 10036
Steven F. Goldstone	570 Lexington Avenue, 37th Floor New York, New York 10022
William B. Harrison, Jr.	277 Park Avenue, 35th Floor New York, New York 10172
Harry R. Jacobson, M.D.	3401 West End Avenue, Suite 300 Nashville, Tennessee 37203
William N. Kelley, M.D.	421 Curie Boulevard Philadelphia, Pennsylvania 19104-6160
Rochelle B. Lazarus	636 11th Avenue New York, New York 10036
Carlos E. Represas	Av. Ejercito Nacional No. 453 Colonia Granada, 11520 Mexico, D.F. Mexico
Thomas E. Shenk, Ph.D	Washington Road Princeton, New Jersey 08544-1014
Anne M. Tatlock	One Merck Drive Whitehouse Station, New Jersey 08889-0100
Samuel O. Thier, M.D.	55 Fruit Street, Bulfinch 370 Boston, Massachusetts 02114-2606

Wendell P. Weeks	1 Riverfront Plaza Corning, New York 14831
Peter C. Wendell	2884 Sand Hill Road, Suite 100 Menlo Park, California 94025

IN WITNESS WHEREOF, Merck & Co., Inc. caused this Restated Certificate of Incorporation to be duly executed as of November 2nd, 2009.

MERCK & CO., INC.

By: Celia A Colbert
Name: Celia A. Colbert
Title: Senior Vice President, Secretary and Assistant General Counsel

Signature Page to Restated Certificate of Incorporation of Merck & Co., Inc.

STATE OF NEW JERSEY
DEPARTMENT OF TREASURY
FILING CERTIFICATION (CERTIFIED COPY)

MERCK SHARP & DOHME CORP.

I, the Treasurer of the State of New Jersey, do hereby certify, that the above named business did file and record in this department the below listed document(s) and that the foregoing is a true copy of the
Certificate of Restated Incorporation
Filed in this office on November 2nd, 2009
as the same is taken from and compared with the original(s) filed in this office on the date set forth on each instrument and now remaining on file and of record in my office.

IN TESTIMONY WHEREOF, I have hereunto set my hand and affixed my Official Seal at Trenton, this 2nd day of November, 2009

R. David Rousseau
State Treasurer

Certificate Number: 115657458
Verify this certificate online at
https://www1.state.nj.us/TYTR_StandingCert/JSP/Verify_Cert.jsp

James Stewart
LOWENSTEIN SANDLER PC
65 Livingston Avenue
Roseland, NJ 07068
Tel: 973-597-2500
Fax: 973-597-2400
Attorney for Third-Party Defendant(s) Purdue Pharma Technologies Inc. and Nappwood Land Corporation.

NEW JERSEY DEPARTMENT OF ENVIRONMENTAL PROTECTION, THE COMMISSIONER OF THE NEW JERSEY DEPARTMENT OF ENVIRONMENTAL PROTECTION, and THE ADMINISTRATOR OF THE NEW JERSEY SPILL COMPENSATION FUND, Plaintiffs, v. OCCIDENTAL CHEMICAL CORPORATION, TIERRA SOLUTIONS, INC., MAXUS ENERGY CORPORATION, REPSOL YPF, S.A., YPF, S.A.; YPF HOLDINGS, INC. and CLH HOLDINGS, INC., Defendants.	:	SUPERIOR COURT OF NEW JERSEY LAW DIVISION ESSEX COUNTY DOCKET NO.: ESX-L-9868-05 (PASR) <u>CIVIL ACTION</u> **CERTIFICATION OF ANTHONY M. RONCALLI TO SUPPORT AFFILIATION OF PURDUE PHARMA TECHNOLOGIES, INC. AND NAPPWOOD LAND CORPORATION**

Anthony M. Roncalli makes this certification to document that Nappwood Land Corporation (Nappwood) is and was always a wholly-owned subsidiary of Purdue Pharma Technologies, Inc. (PPTI) and states as follows:

1. I am outside corporate counsel for PPTI and make this certification based on the corporate records of PPTI and Nappwood.

2. Nappwood has owned the Purdue Pharma Site in Lodi, New Jersey since May, 1980 and leased it to PPTI. Nappwood did not conduct any operations on the Site and did not lease the Site to any entity other than PPTI.

3. PPTI has gone through several name changes.

(a) In May, 1980, PPTI was known as Napp Chemicals, Inc. See the Certificate of Ownership and Merger filed March 20, 1973, merging Napp Chemicals, Inc. and Napp-Clifton, Inc. into Napp-Lodi, Inc. (name changed to Napp Chemicals, Inc.) attached as Exhibit 1.

(b) In April, 1993, Napp Chemicals, Inc. changed its name to Napp Technologies, Inc. See Certificate of Amendment to the Certificate of Incorporation filed April 17, 1993 of Napp Chemicals, Inc. changing its name to Napp Technologies, Inc. attached as Exhibit 2.

(c) In April, 2002, Napp Technologies, Inc. changed its name to Purdue Services Inc. See Certificate of Amendment to the Certificate of Incorporation filed April 10, 2002 of Napp Technologies, Inc. changing its name to Purdue Services Inc. attached as Exhibit 3.

(d) In October, 2002, Purdue Services Inc. changed its name to PPTI. See Certificate of Amendment to the Certificate of Incorporation filed October 7, 2002 of Purdue Services Inc. changing its name to Purdue Pharma Technologies Inc. attached as Exhibit 4.

4. Nappwood is and was since its formation a wholly-owned subsidiary of PPTI under any of PPTI's various names. See Share Certificate # 1 dated May 22, 1980 for 100 shares issued to Napp Chemicals, Inc. attached as Exhibit 5.

5. Nappwood's only asset is ownership of the Purdue Pharma Site real estate.

I certify that the foregoing statements made by me are true. I am aware that if any of the foregoing statements are willfully false, I am subject to punishment.

Name:
Anthony M. Roncalli, Esq.

March 5, 2013
Date

Exhibit 1

State
of
DELAWARE

Office of SECRETARY OF STATE

I, Michael Harkins, Secretary of State of the State of Delaware, do hereby certify that the attached is a true and correct copy of

Certificate of Ownership

filed in this office on March 30, 1973

DEPARTMENT OF STATE
OFFICE OF THE SECRETARY OF STATE
DELAWARE

Michael Harkins

Michael Harkins, Secretary of State

BY: M. Mafurugen

DATE: February 15, 1991

Form 130

CERTIFICATE OF OWNERSHIP AND MERGER

MERGING

NAPP CHEMICALS, INC.

AND

NAPP-CLIFTON, INC.

INTO

NAPP-LODI, INC.

* * * * *

NAPP-LODI, INC., a corporation organized and existing under the laws of Delaware, DOES HEREBY CERTIFY:

FIRST: That this corporation was incorporated on the 17th day of December, 1970, pursuant to the General Corporation Law of the State of Delaware.

SECOND: That this corporation owns all of the outstanding shares of the stock of NAPP CHEMICALS, INC., a corporation incorporated on the 12th day of March, 1971, pursuant to the General Corporation Law of the State of Delaware, and that this corporation owns all of the outstanding shares of the stock of NAPP-CLIFTON, INC., a corporation incorporated on the 17th day of March, 1966, pursuant to Title 14A. Corporations, General Law of the State of New Jersey.

THIRD: That this corporation, by the following resolutions of its Board of Directors, duly adopted by the unanimous written consent of its members, filed with the minutes of the board, on the 14th day of March, 1973, determined to and did merge into itself said NAPP CHEMICALS, INC. and NAPP-CLIFTON, INC.

RESOLVED, that NAPP-LODI, INC., merge, and it hereby does merge into itself said NAPP CHEMICALS, INC. and NAPP-CLIFTON, INC., and assumes all of their obligations; and

FURTHER RESOLVED, that the merger shall become effective at the beginning of the day next following the date of filing with the Secretary of State of Delaware, and

FURTHER RESOLVED, that the proper officers of this corporation be and they hereby are directed to make and execute a Certificate of Ownership and Merger setting forth a copy of the resolutions to merge said NAPP CHEMICALS, INC., and NAPP-CLIFTON, INC., and assume their liabilities and obligations, and the date of adoption thereof, and to cause the same to be filed with the Secretary of State and a certified copy recorded in the office of the Recorder of Deeds of New Castle County and to do all acts and things whatsoever, whether within or without the State of Delaware, which may be in anywise necessary or proper to effect said merger; and

FURTHER RESOLVED, that this corporation change its corporate name to the following: NAPP CHEMICALS, INC.

IN WITNESS WHEREOF, said NAPP-LODI, INC., has caused this certificate to be signed by RAYMOND R. SACKLER its

09013

Vice President and attested by MARTIN GREENE, its Assistant Secretary, this 20th day of March, 1973.

NAPP-LODI, INC.

By Raymond R. Sackler
Raymond Sackler, Vice President

ATTEST:

By Martin Greene
Martin Greene, Assistant Secretary

03919

Exhibit 2

State of Delaware

Office of the Secretary of State

I, WILLIAM T. QUILLEN, SECRETARY OF STATE OF THE STATE OF DELAWARE, DO HEREBY CERTIFY THE ATTACHED IS A TRUE AND CORRECT COPY OF THE CERTIFICATE OF AMENDMENT OF "[illegible], INC." FILED IN THIS OFFICE ON THE SEVENTH DAY OF APRIL, A.D. 1993, AT 11 O'CLOCK A.M.

A CERTIFIED COPY OF THIS CERTIFICATE HAS BEEN FORWARDED TO NEW CASTLE COUNTY RECORDER OF DEEDS FOR RECORDING.

* * * * * * * * * *

William T. Quillen

William T. Quillen, Secretary of State

AUTHENTICATION: [illegible]

DATE: [illegible]

CERTIFICATE OF AMENDMENT
OF
CERTIFICATE OF INCORPORATION
OF
NAPP CHEMICALS, INC.

Dated: April 2, 1993

Napp Chemicals, Inc., a corporation organized and existing under and by virtue of the General Corporation Law of the State of Delaware,

DOES HEREBY CERTIFY:

FIRST: That the Board of Directors of the Corporation has duly adopted resolutions setting forth a proposed amendment of the Certificate of Incorporation of the Corporation, declaring said amendment to be advisable and directing that the amendment be submitted to the stockholders of the Corporation for their consideration. The resolution setting forth the proposed amendment is as follows:

NOW, THEREFORE, BE IT RESOLVED, that Article FIRST of the Certificate of Incorporation of the Corporation be amended to read in its entirety as follows:

> FIRST: The name of the Corporation is Napp Technologies, Inc. (hereinafter referred to as the "Corporation").

SECOND: That thereafter, pursuant to resolution of its Board of Directors, the amendment was submitted to the stockholders of the Corporation and, by unanimous written consent given in accordance with Section 228 of the General Corporation Law of the State of Delaware, the stockholders unanimously voted in favor of the amendment.

THIRD: That said amendment was duly adopted in accordance with the provisions of Section 242 of the General Corporation Law of the State of Delaware.

IN WITNESS WHEREOF, Napp Chemicals, Inc. has caused this Certificate of Amendment to be signed by its executive vice president and attested by its secretary this 2nd day of April, 1993.

NAPP CHEMICALS, INC.

By: Holbrook Bugbee
Holbrook Bugbee
Executive Vice President
Name and Title

ATTEST:

Secretary

030893N2379

04.07.1993 10:43 NO.18 P.3

Exhibit 3

Delaware

The First State

I, HARRIET SMITH WINDSOR, SECRETARY OF STATE OF THE STATE OF DELAWARE, DO HEREBY CERTIFY THE ATTACHED IS A TRUE AND CORRECT COPY OF THE CERTIFICATE OF AMENDMENT OF "NAPP TECHNOLOGIES, INC.", CHANGING ITS NAME FROM "NAPP TECHNOLOGIES, INC." TO "PURDUE SERVICES INC.", FILED IN THIS OFFICE ON THE TENTH DAY OF APRIL, A.D. 2002, AT 9 O'CLOCK A.M.

Harriet Smith Windsor

Harriet Smith Windsor, Secretary of State

0768027 8100

020441137

AUTHENTICATION: 1875204

DATE: 07-10-02

STATE OF DELAWARE
SECRETARY OF STATE
DIVISION OF CORPORATIONS
FILED 09:00 AM 04/10/2002
020229945 - 0768027

CERTIFICATE OF AMENDMENT
OF
NAPP TECHNOLOGIES, INC.

Pursuant to Section 242 of the General Corporation Law of the State of Delaware

Napp Technologies, Inc., a corporation organized and existing under the General Corporation Law of the State of Delaware (the "Corporation"), does hereby certify as follows:

FIRST: Resolutions setting forth the proposed amendment to the Certificate of Incorporation of the Corporation, declaring said amendment to be advisable and directing that said amendment be considered by the stockholders of the Corporation entitled to vote thereon were duly adopted by the Unanimous Written Consent of the Board of Directors of the Corporation dated as of March 26, 2002.

SECOND: Thereafter, said amendment was approved in accordance with Section 228 of the General Corporation Law of the State of Delaware by the Unanimous Written Consent dated as of March 26, 2002 of the stockholders of the Corporation entitled to vote thereon.

THIRD: Said amendment would amend the Certificate of Incorporation of the Corporation by deleting Article FIRST and substituting in lieu thereof the following new Article FIRST:

"FIRST: The name of the Corporation is Purdue Services Inc. (the "Corporation")."

NY2 - 324160.01

FOURTH: Said amendment was duly adopted in accordance with the provisions of Section 242 of the General Corporation Law of the State of Delaware.

IN WITNESS WHEREOF, the Corporation has caused this certificate to be signed by its Vice President and attested by its Secretary as of this 26th day of March, 2002.

NAPP TECHNOLOGIES, INC.

By____________________
Edward Murray
Vice President

ATTEST:

By____________________
Howard R. Udell
Secretary

NYI - 324550.01

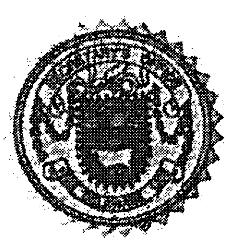
Exhibit 4

Delaware

The First State

I, HARRIET SMITH WINDSOR, SECRETARY OF STATE OF THE STATE OF DELAWARE, DO HEREBY CERTIFY THE ATTACHED IS A TRUE AND CORRECT COPY OF THE CERTIFICATE OF AMENDMENT OF "PURDUE SERVICES INC.", CHANGING ITS NAME FROM "PURDUE SERVICES INC." TO "PURDUE PHARMA TECHNOLOGIES INC.", FILED IN THIS OFFICE ON THE SEVENTH DAY OF OCTOBER, A.D. 2002, AT 9 O'CLOCK A.M.

A FILED COPY OF THIS CERTIFICATE HAS BEEN FORWARDED TO THE NEW CASTLE COUNTY RECORDER OF DEEDS.



Harriet Smith Windsor

Harriet Smith Windsor, Secretary of State

0768027 8100

020621579

AUTHENTICATION: 2023564

DATE: 10-07-02

STATE OF DELAWARE
SECRETARY OF STATE
DIVISION OF CORPORATIONS
FILED 09:00 AM 10/07/2002
020621579 – 0768027

CERTIFICATE OF AMENDMENT
OF
PURDUE SERVICES INC.

Pursuant to Section 242 of the General Corporation Law of the State of Delaware

Purdue Services Inc., a corporation organized and existing under the General Corporation Law of the State of Delaware (the "Corporation"), does hereby certify as follows:

FIRST: Resolutions setting forth the proposed amendment to the Certificate of Incorporation of the Corporation, declaring said amendment to be advisable and directing that said amendment be considered by the stockholders of the Corporation entitled to vote thereon were duly adopted by the Board of Directors of the Corporation on September 25, 2002.

SECOND: Thereafter, said amendment was approved in accordance with Section 222 of the General Corporation Law of the State of Delaware on September 25, 2002 by the stockholders of the Corporation entitled to vote thereon.

THIRD: Said amendment would amend the Certificate of Incorporation of the Corporation by deleting Article FIRST and substituting in lieu thereof the following new Article FIRST:

"FIRST: The name of the Corporation is Purdue Pharma Technologies Inc. (the "Corporation")."

FOURTH: Said amendment was duly adopted in accordance with the provisions of Section 242 of the General Corporation Law of the State of Delaware.

IN WITNESS WHEREOF, the Corporation has caused this certificate to be signed by its Vice President and attested by its Secretary as of this 7th day of October, 2002.

PURDUE SERVICES INC.

By ______________________
Edward Murray
Vice President

ATTEST:

By ______________________
Howard R. Udell
Secretary

NY2 - 340516.09

Exhibit 5

No. 1

100 Shares

Incorporated under the Laws of the State of New Jersey

Nappwood Land Corporation

SHARES OF COMMON STOCK

PAR VALUE $1.00 EACH

This Certifies that NAPP CHEMICALS, INC. *is the owner of* *** One Hundred *** *fully paid and non-assessable Shares of the above-named Corporation, transferable on the books of the Corporation by the holder hereof in person or by duly authorized Attorney upon surrender of this Certificate properly endorsed.*

Witness *the seal of the Corporation and the signatures of its duly authorized officers.*

Dated May 22, 1980

Secretary ~~XXXXXX~~

~~XXXXXXXXX~~ *President*

HASBROUCK THISTLE & CO NEW YORK

Exhibit 2.1

AGREEMENT AND PLAN OF MERGER

Among

CHRIS-CRAFT INDUSTRIES, INC.,

THE NEWS CORPORATION LIMITED,

NEWS PUBLISHING AUSTRALIA LIMITED,

and

FOX TELEVISION HOLDINGS, INC.

Dated as of August 13, 2000

TABLE OF CONTENTS

ARTICLE IV

REPRESENTATIONS AND WARRANTIES OF BUYER

ARTICLE V

CONDUCT OF BUSINESS PENDING THE MERGER

ARTICLE VI

ADDITIONAL AGREEMENTS

ARTICLE VII

CONDITIONS TO THE MERGER

ARTICLE VIII

TERMINATION, AMENDMENT AND WAIVER

ARTICLE IX

GENERAL PROVISIONS

EXHIBITS

TABLE OF DEFINED TERMS

AGREEMENT AND PLAN OF MERGER dated as of August 13, 2000 (this "Agreement") by and among CHRIS-CRAFT INDUSTRIES, INC., a Delaware corporation (the "Company"), THE NEWS CORPORATION LIMITED, a South Australian corporation ("Buyer"), NEWS PUBLISHING AUSTRALIA LIMITED, a Delaware corporation and a subsidiary of Buyer ("Acquisition Sub") and FOX TELEVISION HOLDINGS, INC., a Delaware corporation ("FTH") (but solely as to Section 6.3 and Section 6.20 of this Agreement).

WHEREAS, in furtherance of the acquisition of the Company by Buyer, the respective Boards of Directors of the Company, Buyer and Acquisition Sub, and Buyer, as the sole stockholder of Acquisition Sub, have each approved this Agreement and the merger of (A) the Company with and into Acquisition Sub (the "Forward Merger") and (B) in the event a Restructuring Trigger (as defined herein) has occurred, the merger of Acquisition Sub with and into the Company (the "Reverse Merger" and, together with the Forward Merger, as applicable, the "Merger"), in each case upon the terms and subject to the conditions and limitations set forth herein and in accordance with the General Corporation Law of the State of Delaware ("Delaware Law"), whereby each share of the issued and outstanding shares of Common Stock of the Company, par value $.50 per share (the "Common Stock"), each share of the issued and outstanding shares of Class B Common Stock of the Company, par value $.50 per share (the "Class B Common Stock"), and each share of the issued and outstanding shares of Convertible Preferred Stock of the Company, par value $1.00 per share (the "Convertible Preferred Stock" and, collectively with the Common Stock and the Class B Common Stock, the "Common Stock Equivalents") will, upon the terms and subject to the conditions and limitations set forth herein, be converted into the Merger Consideration (as defined herein) as determined in accordance with Article I hereof;

WHEREAS, the Board of Directors of the Company (i) has determined that the Merger is fair to, advisable and in the best interests of, the Company and its stockholders and has approved and adopted this Agreement, the Merger and the other transactions contemplated by this Agreement and (ii) has recommended the approval of this Agreement by the stockholders of the Company;

WHEREAS, for Federal income tax purposes, it is intended that the Forward Merger shall qualify as a reorganization under the provisions of Section 368(a) of the United States Internal Revenue Code of 1986, as amended (the "Code");

WHEREAS, simultaneously with the execution and delivery of this Agreement, Buyer is entering into an agreement and plan of merger with BHC Communications, Inc. ("BHC"), a Delaware corporation and a direct subsidiary of the Company (the "BHC Merger Agreement"), providing for the merger of BHC with and into Acquisition Sub or, if a Restructuring Trigger has occurred, the merger of a direct or indirect subsidiary of Buyer (or of the Company) with and into BHC, in each case upon the terms and subject to the conditions set forth in the BHC Merger Agreement (the "BHC Merger");

WHEREAS, simultaneously with the execution and delivery of this Agreement, Buyer is entering into an agreement and plan of merger with United Television, Inc. ("UTV"), a Delaware corporation and an indirect subsidiary of the Company (the "UTV Merger Agreement" and, together with the BHC Merger Agreement, the "Subsidiary Merger Agreements"), providing for the merger of UTV with and into Acquisition Sub or, if a Restructuring Trigger has occurred, the merger of a direct or indirect subsidiary of Buyer (or of BHC) with and into UTV, in each case upon the terms and subject to the conditions set forth in the UTV Merger Agreement (the "UTV Merger" and, together with the BHC Merger, the "Subsidiary Mergers"); and

WHEREAS, it is intended that the mergers heretofore referred to shall be completed in the following order: first, the Merger; second, the BHC Merger; and third, the UTV Merger;

NOW, THEREFORE, in consideration of the foregoing and the mutual covenants and agreements herein contained and intending to be legally bound hereby, the parties hereto hereby agree as follows:

ARTICLE I

THE MERGER

Section 1.1 The Merger.

(a) Upon the terms and subject to the conditions of this Agreement, and in accordance with Delaware Law, at the Effective Time (as defined below), in the case of the Forward Merger, the Company shall be merged with and into Acquisition Sub, whereupon the separate existence of the Company shall cease, and Acquisition Sub shall continue as the surviving corporation and, in the case of the Reverse Merger, Acquisition Sub shall be merged with and into the Company, whereupon the separate corporate existence of Acquisition Sub shall cease, and the Company shall continue as the surviving corporation (the surviving corporation in the Merger is sometimes referred to herein as the "Surviving Corporation") and shall continue to be governed by the laws of the State of Delaware and shall continue under the name "News Publishing Australia Limited." Whether the Forward Merger or the Reverse Merger is to be effected shall be determined in accordance with Section 6.19 hereof.

(b) Concurrently with the Closing (as defined in Section 1.10 hereof), the Company, Buyer and Acquisition Sub shall cause a certificate of merger (the "Certificate of Merger") with respect to the Merger to be executed and filed with the Secretary of State of the State of Delaware (the "Secretary of State") as provided under Delaware Law. The Merger shall become effective on the date and time at which the Certificate of Merger has been duly filed with the Secretary of State or at such other date and time as are agreed between the parties and specified in the Certificate of Merger, and such date and time is hereinafter referred to as the "Effective Time."

(c) From and after the Effective Time, the Surviving Corporation shall possess all rights, privileges, immunities, powers and franchises and be subject to all of the obligations, restrictions, disabilities, liabilities, debts and duties of the Company and Acquisition Sub.

Section 1.2 Effect on Securities.

At the Effective Time:

(a) Cancellation of Securities. Each share of Common Stock

Equivalents held by the Company as treasury stock or held by Buyer or its subsidiaries immediately prior to the Effective Time shall automatically be cancelled and retired and revert to the status of authorized but unissued shares and no consideration or payment shall be delivered therefor or in respect thereto.

(b) Conversion of Securities. Except as otherwise provided in this Agreement and subject to Section 1.4 hereof, each share of Common Stock Equivalents issued and outstanding immediately prior to the Effective Time (other than shares cancelled pursuant to Section 1.2(a) hereof and Dissenting Shares (as defined in Section 1.9 hereof)) shall be converted into the following (the "Merger Consideration"):

Either (X) in the case of the Forward Merger:

(i) for each share of Common Stock Equivalents with respect to which an election to receive only cash (to the extent available) has been effectively made and not revoked or lost, pursuant to Section 1.3 hereof, the right to receive in cash from Buyer the Per Share Amount (as defined below), subject to Sections 1.2(f) and 1.4(f) and to the allocation and proration procedures set forth in Section 1.4 hereof; and

(ii) for each share of Common Stock Equivalents with respect to which an election to receive forty percent (40%) of the Cash Merger Price in cash and the remainder of the Merger Consideration in American Depositary Shares of Buyer ("Buyer Shares"), each of which represents four (4) fully paid and nonassessable Preferred Limited Voting Ordinary Shares, of Buyer ("Buyer Preferred Stock"), has been effectively made and not revoked or lost, pursuant to Section 1.3 hereof (a "Partial Cash Election"), (A) the right to receive from Buyer an amount in cash equal to $34, or if the Effective Time shall occur after the one year anniversary of the date hereof, $35 and (B) 1.1591 (the "Partial Exchange Ratio") Buyer Shares (such shares of Common Stock Equivalents being, collectively, "Partial Cash Election Shares" and, together with the All Cash Election Shares (as defined herein), "Cash Election Shares"); provided, however, that the foregoing shall be subject to Sections 1.2(f) and 1.4(f) hereof. The Buyer Preferred Stock allotted and issued in accordance with this Agreement shall on and from its date of allotment rank pari passu with all existing Buyer Preferred Stock on issue at that date including, as to all dividend entitlements (in respect of which they shall receive the same entitlement as any previously issued Buyer Preferred Stock); and

(iii) for each other share of Common Stock Equivalents, the right to receive from Buyer, the number of Buyer Shares equal to the Exchange Ratio (as defined below), subject to Sections 1.2(f) and 1.4(f) and to the allocation and proration procedures set forth in Section 1.4 hereof; or

(Y) in the case of the Reverse Merger, subject to Section 1.2(f), for each share of Common Stock Equivalents, (A) the right to receive from Buyer an amount in cash equal to $36 or, if the Effective Time shall occur after the one year anniversary of the date hereof, $37 and (B) 1.2273 Buyer Shares (the "Reverse Merger Exchange Ratio").

(c) All shares of Common Stock Equivalents to be converted into the Merger Consideration pursuant to this Section 1.2 shall, by virtue of the Merger and without any action on the part of the holders thereof, cease to be outstanding, be cancelled and retired and cease to exist; and each holder of a certificate representing prior to the Effective Time any such shares of Common Stock Equivalents shall thereafter cease to have any rights with respect to such securities, except the right to receive (i) the Merger Consideration, (ii) any dividends and other distributions in accordance with Section 1.5(c) hereof and (iii) any cash to be paid in lieu of any fractional Buyer Share in accordance with Section 1.5(d) hereof.

(d) The shares of Convertible Preferred Stock shall be entitled to make elections (in the case of the Forward Merger) and shall be entitled to receive the Merger Consideration in all cases as if such shares had been converted in accordance with the Restated Certificate of Incorporation of the Company (the "Restated Certificate of Incorporation").

(e) Capital Stock of Acquisition Sub. In the Forward Merger, no shares of Acquisition Sub stock will be issued directly or indirectly and each share of common stock of Acquisition Sub issued and outstanding immediately prior to the Effective Time shall remain outstanding following the Effective Time. In the case of the Reverse Merger, each share of common stock of Acquisition Sub shall be converted into one fully paid and nonassessable share of the Surviving Corporation.

(f) Adjustments to Exchange Ratio.

(i) Subject to clause (ii) below, in the event that Buyer declares or effects a stock split, stock or cash dividend (other than ordinary course cash dividends declared and paid consistent with past practice) or other reclassification, acquisition, exchange or distribution with respect to the Buyer Shares or Buyer Preferred Stock, in each case with a record or ex-dividend date or effective date occurring after the date hereof and on or prior to the date of the Effective Time, there will be an appropriate adjustment made to the Merger Consideration so as to provide for the inclusion therein of the cash, property, securities or combination thereof that each holder of Common Stock Equivalents who has the right to receive the Merger Consideration pursuant to Section 1.2 hereof would have received had such Common Stock Equivalents been converted into Buyer Shares or Buyer Preferred Stock as of the date hereof.

(ii) If either (A) in the case of the Forward Merger, the tax opinion to the Company referred to in Section 7.3(c) hereof as to the Merger qualifying as a reorganization cannot be rendered (as reasonably determined by Skadden, Arps, Slate, Meagher & Flom LLP), (B) in the case of the Forward Merger, the tax opinion to Buyer referred to in Section 7.2(f) as to the Merger qualifying as a reorganization cannot be rendered (as reasonably determined by Squadron, Ellenoff, Plesent & Sheinfeld LLP), (C) in the case of the Forward Merger, in the reasonable judgment of the Company or Buyer, based on the advice of their respective counsel, there is a meaningful risk that the receipt of the cash, property, securities or combination thereof referred to in clause (i) above would be taxable or have an adverse tax consequence to the holders of Common Stock Equivalents or (D) in the case of either the Forward Merger or the Reverse Merger, the adjustment referred to in clause (i) above is not possible or not possible without materially changing the tax treatment of the transaction referred to in clause (i) in question, then, in each case, Buyer (but only if requested by the Company in the case of clause (C) above) shall make an appropriate adjustment to the Merger Consideration that (x) conveys an equivalent value (taking into account, among other things, the impact of the transaction referred to in clause (i) above on the trading price of Common Stock, Buyer Shares, Buyer Preferred Stock and any newly issued securities) to the holders of Common Stock Equivalents as the adjustments contemplated in paragraph (i) above, (y) in the case of the Forward Merger, allows such tax opinions to be delivered and (z) in the case of the Forward Merger, avoids the consequences referred to in clause (C) above; it being understood that, by way of illustration and not limitation, the Company's written agreement that clause (x) is satisfied shall constitute conclusive evidence as to such fact.

(g) Certain Definitions. For purposes of this Agreement, or, in the case of clause (xii) below, solely for purposes of Sections 1.2, 1.3 and 1.4 hereof, the following terms shall have the following meanings:

(i) "Aggregate Buyer Share Amount" means (A) 60% of the product of (x) the number of shares of Common Stock Equivalents (on an as converted basis) issued and outstanding immediately prior to the Effective Time, less the number of outstanding shares of Common Stock Equivalents cancelled pursuant to Section 1.2(a) hereof, and (y) 1.9318, less (B) the number of Buyer Shares to be paid in respect of Partial Cash Election Shares, in each case subject to adjustment as described in Section 1.4(f) hereof.

(ii) "Aggregate Cash Amount" means (A) the product of (x) the number of shares of Common Stock Equivalents (on an as converted basis) issued and outstanding immediately prior to the Effective Time, less the number of outstanding shares of Common Stock Equivalents cancelled pursuant to Section 1.2(a) hereof and (y) $34 or, if the Effective Time shall occur after the one year anniversary of the date hereof, $35, less (B) the amount of cash to be paid in respect of Partial Cash Election Shares, in each case subject to adjustment as described in Section 1.4(f) hereof.

(iii) "All Cash Election Number" means (A) that number of shares of Common Stock Equivalents as shall be equal to the quotient obtained by dividing the Aggregate Cash Amount by the Per Share Amount, less (B) the number of Dissenting Shares, subject to adjustment as described in Section 1.4(f) hereof.

(iv) "Cash Merger Price" means $85.

(v) "Closing Buyer Share Value" means the volume weighted average sales price for all trades of Buyer Shares reported on the New York Stock Exchange (the "NYSE") for each of the five trading days immediately preceding but not including the Closing Date (the "Valuation Period"); provided, however, if necessary to comply with any requirements of the Securities and Exchange Commission (the "SEC"), the term Closing Date in this clause (iv) shall be deemed to mean the date which is the closest in time but prior to the Closing Date which complies with such rules and regulations. Buyer agrees that during the Valuation Period neither Buyer nor its affiliates shall (x) purchase or acquire, or offer to purchase or acquire, or announce any intention to purchase or acquire, any Buyer Shares or Buyer Preferred Stock or other outstanding securities of Buyer or its affiliates convertible into Buyer Shares or Buyer Preferred Stock (other than purchases at market value of Buyer Shares (in accordance with all applicable laws) by a broker who has full discretion as to the amount and timing of such purchases pursuant to a pre-existing stock buyback program) or (y) announce or effect any material corporate transaction.

(vi) "Closing Transaction Value" means the sum of (A) the Aggregate Cash Amount and (B) the product obtained by multiplying the Aggregate Buyer Share Amount by the Closing Buyer Share Value.

(vii) "Exchange Ratio" means that number of Buyer Shares as shall be obtained by dividing the Per Share Amount by the Closing Buyer Share Value.

(viii)"Exchangeable Shares" means the aggregate number of shares of Common Stock Equivalents (on an as converted basis) issued and outstanding immediately prior to the Effective Time less the number of such shares cancelled pursuant to Section 1.2(a) hereof and less the aggregate number of Partial Cash Election Shares.

(ix) "Exchanged Shares" means the aggregate number of shares of Common Stock Equivalents (on an as converted basis) issued and outstanding immediately prior to the Effective Time less the number of such shares (A) cancelled pursuant to Section 1.2(a) hereof and (B) that are Dissenting Shares.

(x) "Per Share Amount" means the amount obtained by dividing the Closing Transaction Value by the number of Exchangeable Shares.

(xi) "Stock Election Number" means that number of shares of Common Stock Equivalents as shall be equal to (A) the number of Exchanged Shares less (B) the sum of (i) the All Cash Election Number and (ii) the aggregate number of Partial Cash Election Shares, subject to adjustment as described in Section 1.4(f) hereof.

(xii) "Dissenting Shares" means shares of Common Stock Equivalents that are Dissenting Shares within the meaning of Section 1.9 hereof in respect of which the holder thereof shall have taken all steps necessary to exercise and perfect properly his or her demand for appraisal under Section 262 of the Delaware Law to the extent that such steps are required to have been taken by the applicable date of determination.

Section 1.3 Share Election. In the case of the Forward Merger (and, with respect to clauses (b) and, unless a Restructuring Trigger has theretofore occurred, (c) and (e) below, in the case of the Reverse Merger to the extent applicable):

(a) Each Person (as defined in Section 1.3(b) hereof) who, on or prior to the Election Deadline referred to in subsection (c) below is a record holder of shares of Common Stock Equivalents (collectively, "Holders") shall have the right, with respect to the Merger Consideration, (i) to elect to receive only cash for such shares pursuant to Section 1.2(b)(X)(i) hereof (an "All Cash Election"), (ii) to make a Partial Cash Election, (iii) to elect to receive Buyer Shares for such shares pursuant to Section 1.2(b)(X)(iii) hereof (a "Stock Election"), (iv) to indicate that such record holder has no preference as to the receipt of cash or Buyer Shares for such shares (a "Non-Election") or (v) to make a mixed election, specifying the number of shares of Common Stock Equivalents corresponding with each such Election (the All Cash Election, the Partial Cash Election, the Stock Election, and the Non-Election are collectively referred to as the "Elections"). Holders who hold such shares as nominees, trustees or in other representative capacities may submit multiple Forms of

Election (as defined below).

(b) Prior to the mailing of the Proxy Statement (as defined in Section 6.1 hereof), The Bank of New York or such other bank, trust company, Person or Persons shall be designated by Buyer and reasonably acceptable to the Company to act as exchange agent (the "Exchange Agent") for payment of the Merger Consideration. The Exchange Agent shall act as the agent for the Company's stockholders for the purpose of receiving and holding their Forms of Election and Certificates (as defined below) and shall obtain no rights or interests (beneficial or otherwise) in such shares. For purposes of this Agreement, "Person" means any natural person, firm, individual, corporation, limited liability company, partnership, association, joint venture, company, business trust, trust or any other entity or organization, whether incorporated or unincorporated, including a government or political subdivision or any agency or instrumentality thereof.

(c) All Elections shall be made on a form designed for that purpose, which shall include a letter of transmittal and election form (together, a "Form of Election"). Elections shall be made by Holders by mailing to the Exchange Agent a Form of Election, which shall specify that delivery shall be effected, and risk of loss and title to any Certificates shall pass, only upon proper delivery of the Certificates to the Exchange Agent and shall be in such form and have such other provisions as Buyer, in consultation with the Company, may reasonably specify. Buyer and the Company will announce the Exchange Ratio and the Per Share Amount when known and will announce the anticipated Closing Date at least three business days, but not more than five business days, prior thereto; provided, however, that the Closing Date shall not be earlier than the second business day after the satisfaction or waiver of all conditions set forth in Article VII hereof (other than the conditions set forth in Sections 7.2(a), 7.2(b) 7.2(f), 7.3(a), 7.3(b), 7.3(c) and, in so far as it relates to the accuracy of representations and warranties and the performance of covenants, Section 7.1(h), so long as the foregoing enumerated conditions are anticipated by the parties hereto to be satisfied on the Closing Date). All Certificates so surrendered shall be subject to the exchange procedures set forth in Section 1.5 hereof. To be effective, a Form of Election must be properly completed, signed and submitted to the Exchange Agent and accompanied by the Certificates as to which the election is being made (or by an appropriate guarantee of delivery of such Certificates as set forth in such Form of Election from a firm which is a member of the NYSE or another registered national securities exchange or a commercial bank or trust company having an office or correspondent in the United States, provided such Certificates are in fact delivered to the Exchange Agent within five NYSE trading days after the Election Deadline (as defined below)). Buyer will have the discretion, which it may delegate in whole or in part to the Exchange Agent, to determine whether Forms of Election have been properly completed, signed and submitted or revoked and to disregard immaterial defects in Forms of Election. The decision of Buyer (or the Exchange Agent) in such matters, absent manifest error, shall be conclusive and binding. Neither Buyer nor the Exchange Agent will be under any obligation to notify any person of any defect in a Form of Election submitted to the Exchange Agent. The Exchange Agent and Buyer shall also make all computations contemplated by this Section 1.3 and by Section 1.4 hereof and all such computations shall be conclusive and binding on the Holders absent manifest error. The Form of Election and the accompanying Certificates (or appropriate guarantee of delivery in respect thereof) must be received by the Exchange Agent prior to 10:00 a.m. New York City time on the day on which the Closing occurs (the "Election Deadline") in order to be effective. If the Closing is delayed to a subsequent date, the Election

Deadline shall be similarly delayed and Buyer will promptly announce such rescheduled Election Deadline and Closing. An election may be revoked, but only by written notice received by the Exchange Agent prior to the Election Deadline. Upon any such revocation, unless a duly completed Election Form, accompanied by a Certificate, is thereafter submitted in accordance with this paragraph (c), such shares shall be deemed to be Non-Election Shares (as defined in Section 1.4 hereof). If a Form of Election is revoked, or in the event that this Agreement is terminated pursuant to the provisions hereof, and any Certificates (or guarantee(s) of delivery, as appropriate), have been transmitted to the Exchange Agent pursuant to the provisions hereof, such Certificates (and, in the case of a revoked Form of Election, guarantee(s) of delivery, as appropriate), shall promptly be returned without charge to the Person submitting the same.

(d) For the purposes hereof, Common Stock Equivalents as to which the Holder has not made a valid Election prior to the Election Deadline, including as a result of revocation, shall be deemed to be Non-Electing Shares. If Buyer or the Exchange Agent shall determine that any purported All Cash Election, Partial Cash Election or Stock Election was not properly made, such purported All Cash Election, Partial Cash Election or Stock Election shall be deemed to be of no force and effect and the Holder making such purported All Cash Election, Partial Cash Election or Stock Election shall for purposes hereof be deemed to have made a Non-Election. Shares in respect of which a Non-Election shall have been made or deemed made shall be treated as Non-Election Shares.

(e) Concurrently with the mailing of the Proxy Statement, Buyer and the Company shall mail the Form of Election to each person who is a Holder on the record date for the Stockholder's Meeting (as defined in Section 6.2 hereof) and shall each use its reasonable best efforts to mail the Form of Election to all persons who become Holders during the period between (i) such record date and (ii) the date seven calendar days prior to the anticipated Effective Time, and to make the Form of Election available to all persons who become Holders subsequent to the date described in clause (ii) but not later than 5:00 p.m. New York City time on the last business day prior to the Effective Time. The Exchange Agent may, with the mutual agreement of Buyer and the Company, make such rules as are consistent with this Section 1.3 for the implementation of the Elections provided for herein as shall be necessary or desirable to effect such Elections fully.

Section 1.4 Allocation and Proration. In the case of the Forward Merger:

(a) Notwithstanding anything in this Agreement to the contrary, the maximum number of shares of Common Stock Equivalents (on an as converted basis) which shall be converted into the right to receive cash in the Merger (other than pursuant to Partial Cash Elections and other than Dissenting Shares) shall be equal to the All Cash Election Number. The maximum number of shares of Common Stock Equivalents (on an as converted basis) to be converted into the right to receive Buyer Shares in the Merger (other than pursuant to Partial Cash Elections) shall be equal to the Stock Election Number.

(b) If the aggregate number of shares of Common Stock Equivalents covered by All Cash Elections (the "All Cash Election Shares") exceeds the All Cash Election Number, all shares of Common Stock Equivalents covered by Stock Elections (the "Stock Election Shares") and all shares of Common Stock Equivalents covered by Non-Elections (the "Non-Election Shares") shall be converted into the right to receive Buyer

Shares, and the All Cash Election Shares shall be converted into the right to receive Buyer Shares and cash in the following manner:

each All Cash Election Share shall be converted into the right to receive (i) an amount in cash, without interest, equal to the product of (x) the Per Share Amount and (y) a fraction (the "Cash Fraction"), the numerator of which shall be the All Cash Election Number and the denominator of which shall be the total number of All Cash Election Shares, and (ii) a number of shares of Buyer Shares equal to the product of (x) the Exchange Ratio and (y) a fraction equal to one minus the Cash Fraction.

(c) If the aggregate number of Stock Election Shares exceeds the Stock Election Number, all All Cash Election Shares and all Non-Election Shares shall be converted into the right to receive cash, and the Stock Election Shares shall be converted into the right to receive Buyer Shares and cash in the following manner:

each Stock Election Share shall be converted into the right to receive (i) a number of Buyer Shares equal to the product of (x) the Exchange Ratio and (y) a fraction (the "Stock Fraction"), the numerator of which shall be the Stock Election Number and the denominator of which shall be the total number of Stock Election Shares, and (ii) an amount in cash, without interest, equal to the product of (x) the Per Share Amount and (y) a fraction equal to one minus the Stock Fraction.

(d) In the event that neither Section 1.4(b) nor 1.4(c) above is applicable, all All Cash Election Shares shall be converted into the right to receive cash, all Stock Election Shares shall be converted into the right to receive Buyer Shares and the Non-Election Shares shall be converted into the right to receive Buyer Shares and cash in the following manner:

each Non-Election Share shall be converted into the right to receive (i) an amount in cash, without interest, equal to the product of (x) the Per Share Amount and (y) a fraction (the "Non-Election Fraction"), the numerator of which shall be the excess of the All Cash Election Number over the total number of All Cash Election Shares and the denominator of which shall be the excess of (A) the number of Exchangeable Shares over (B) the sum of the total number of All Cash Election Shares and the total number of Stock Election Shares and (ii) a number of Buyer Shares equal to the product of (x) the Exchange Ratio and (y) a fraction equal to one minus the Non-Election Fraction.

(e) Partial Election Shares shall not be subject to proration and shall be converted into the right to receive the Merger Consideration pursuant to Section 1.2(b)(X)(ii) hereof, subject to Section 1.4(f) hereof.

(f) If the sum of (i) the Aggregate Cash Amount (without giving effect to the reference therein to this subsection (f)) and (ii) (A) (1) $34 or (2) if the Effective Time shall occur after the one year anniversary of the date hereof, $35, multiplied by (B) the number of Partial Cash Election Shares (such sum being the "Cash Amount") exceeds 55% of the sum of (x) the Cash Amount and (y) the product of (A) the closing price of Buyer Shares reported on the NYSE Composite Tape on the trading day immediately preceding the Closing Date (the "Closing Price") multiplied by (B) 1.9318 multiplied by (C) 60% of the excess of the number of Common Stock Equivalents (on an as converted basis) outstanding immediately prior to the Effective Time over the number of outstanding shares of Common Stock Equivalents cancelled pursuant to Section 1.2(a) hereof (such sum of (x) and (y) being the "Total Consideration"), then the components of the Merger Consideration shall be modified (1) first, in the case of shares of Common Stock Equivalents (on an as converted basis) (other than Dissenting Shares) as to which All Cash Elections shall have been made, by reducing the cash portion of the Merger Consideration to the minimum extent necessary, and in no event below the amount of cash payable in respect of Partial Election Shares, and issuing in lieu thereof additional Buyer Shares in an amount equal to the result obtained by dividing (x) the amount of such per share cash reduction by (y) the Closing Price and (2) second, in the event that the foregoing reduction is not sufficient to result in the Cash Amount not exceeding 55% of the Total Consideration, in the case of shares of Common Stock Equivalents as to which an All Cash Election or a Partial Cash Election shall have been made, by further reducing the amount of the cash portion of the Merger Consideration to the minimum extent necessary to satisfy the 55% limitation referred to above and to issue in lieu thereof additional Buyer Shares, in amount equal to the result obtained by dividing (u) the amount of such per share cash reduction by (v) the Closing Price. In the case of the Forward Merger, if either (i) the tax opinion referred to in Section 7.3(c) hereof cannot be rendered (as reasonably determined by Skadden, Arps, Slate, Meagher & Flom LLP), or (ii) the tax opinion to Buyer referred to in Section 7.2(f) cannot be rendered (as reasonably determined by Squadron, Ellenoff, Plesent & Sheinfeld LLP), then the foregoing adjustments shall be similarly made, in each case to the minimum extent necessary to enable the relevant tax opinion or opinions, as the case may be, to be rendered. For purposes of this Section 1.4(f), holders of Dissenting Shares shall be deemed to be Persons making All Cash Elections notwithstanding, and in lieu of, any election they have or have not made.

Section 1.5 Exchange of Certificates.

(a) As of the Effective Time, Buyer shall (i) deposit, or cause to be deposited with (A) the Exchange Agent for the benefit of holders of shares of Common Stock Equivalents, cash to the extent it constitutes Merger Consideration and (B) pursuant to the terms of the Deposit Agreement (as defined below), the Custodian (as defined in the Deposit Agreement) certificates representing the Buyer Preferred Stock underlying the Buyer Shares to the extent they constitute Merger Consideration and (ii) pursuant to the terms of the Deposit Agreement, instruct the Depositary to deposit the Buyer Shares to be issued in the Merger with the Exchange Agent for the benefit of the holders of shares of Common Stock Equivalents for exchange in the Merger. For purposes of this Agreement, "Depositary" shall mean Citibank, N.A., as Depositary, pursuant to the Amended and Restated Deposit Agreement, dated as of December 3, 1996, among Buyer, the Depositary and the holders from time to time of Buyer Shares (the "Deposit Agreement"). In addition, Buyer shall make available to the Exchange Agent on a daily basis sufficient cash to permit prompt payment to all Holders entitled to receive the Merger Consideration in the form of cash. The Buyer shall pay or cause one of its affiliates to pay, any transfer taxes and all other charges and fees (including all fees for the depositary, registry or custodian for the ADRs).

(b) As of or promptly following the Effective Time, the Surviving Corporation shall cause the Exchange Agent to mail (and to make available for collection by hand) to each holder of record of a certificate or certificates, which immediately prior to the Effective Time represented outstanding shares of Common Stock Equivalents (the "Certificates") (other than in the case of the Forward Merger those who had not previously properly delivered their Certificates to the Exchange Agent along with a

Form of Election), (i) a letter of transmittal (which shall specify that delivery shall be effected, and risk of loss and title to the Certificates shall pass, only upon proper delivery of the Certificates to the Exchange Agent and which shall be in the form and have such other provisions as Buyer and the Company may reasonably specify) and (ii) instructions for use in effecting the surrender of the Certificates in exchange for (A) a certificate or certificates representing that number of whole Buyer Shares, if any, into which the number of shares of Common Stock Equivalents previously represented by such Certificate shall have been converted pursuant to this Agreement and (B) the amount of cash, if any, into which all or a portion of the number of shares of Common Stock Equivalents previously represented by such Certificate shall have been converted pursuant to this Agreement (which instructions shall provide that at the election of the surrendering holder, Certificates may be surrendered, and the Merger Consideration in exchange therefor collected, by hand delivery). Upon surrender of a Certificate for cancellation to the Exchange Agent, together with a letter of transmittal duly completed and validly executed in accordance with the instructions thereto, and such other documents as may be required pursuant to such instructions, the holder of such Certificate shall be entitled to receive in exchange therefor the Merger Consideration for each share of Common Stock Equivalents formerly represented by such Certificate, to be mailed (or made available for collection by hand if so elected by the surrendering holder) within five business days following the later to occur of (i) the Effective Time or (ii) the Exchange Agent's receipt of such Certificates, and the Certificate so surrendered shall be forthwith cancelled. The Exchange Agent shall accept such Certificates upon compliance with such reasonable terms and conditions as the Exchange Agent may impose to effect an orderly exchange thereof in accordance with normal exchange practices. No interest shall be paid or accrued for the benefit of holders of the Certificates on the Merger Consideration (or the cash pursuant to subsections (c) and (d) below) payable upon the surrender of the Certificates.

(c) Buyer may retain any dividends or other distributions with respect to Buyer Shares with a record date on or after the Effective Time in respect of the holder of any unsurrendered Certificate with respect to the Buyer Shares represented thereby by reason of the conversion of shares of Common Stock Equivalents pursuant to Sections 1.2(b), 1.3 and 1.4 hereof and no cash payment in lieu of fractional Buyer Shares shall be paid to any such holder pursuant to Section 1.5(d) hereof until such Certificate is surrendered in accordance with this Article I. Subject to the effect of applicable laws, following surrender of any such Certificate, there shall be released and paid, without interest, to the Person in whose name the Buyer Shares representing such securities are registered (i) at the time of such surrender or as promptly as practicable after the sale of the Excess Buyer Shares (as defined in Section 1.5(d) hereof), the amount of any cash payable in lieu of fractional Buyer Shares to which such holder is entitled pursuant to Section 1.5(d) hereof and the proportionate amount of dividends or other distributions with a record date after the Effective Time theretofore paid with respect to the Buyer Shares issued upon conversion of Common Stock Equivalents, and (ii) at the appropriate payment date or as promptly as practicable thereafter, the proportionate amount of dividends or other distributions with a record date after the Effective Time but prior to such surrender and a payment date subsequent to such surrender payable with respect to such Buyer Shares.

(d) Notwithstanding any other provision of this Agreement, no fraction of a Buyer Share will be issued and no dividend or other distribution, stock split or interest with respect to Buyer Shares shall relate to any fractional Buyer Share, and such fractional interest shall not entitle the owner thereof to vote or to any rights as a security holder of the Buyer Shares. In lieu of any such fractional security, each holder of shares of Common Stock Equivalents otherwise entitled to a fraction of a Buyer Share will be entitled to receive in accordance with the provisions of this Section 1.5 from the Exchange Agent a cash payment representing such holder's proportionate interest in the net proceeds from the sale by the Exchange Agent on behalf of all such holders of the aggregate of the fractions of Buyer Shares which would otherwise be issued (the "Excess Buyer Shares"). The sale of the Excess Buyer Shares by the Exchange Agent shall be executed on the NYSE through one or more member firms of the NYSE and shall be executed in round lots to the extent practicable. Until the net proceeds of such sale or sales have been distributed to the holders of shares of Common Stock Equivalents, the Exchange Agent will, subject to Section 1.5(e) hereof, hold such proceeds in trust for the holders of such shares (the "Buyer Shares Trust"). Subject to its right to withhold for taxes as described in Section 1.6 hereof, the Surviving Corporation shall pay all commissions, transfer taxes (other than those transfer taxes for which the Company's former stockholders are solely liable) and other out-of-pocket transaction costs, including the expenses and compensation of the Exchange Agent incurred in connection with such sale of the Excess Buyer Shares. As soon as practicable after the determination of the amount of cash, if any, to be paid to holders of shares of Common Stock Equivalents in lieu of any fractional Buyer Share interests, the Exchange Agent shall make available such amounts to such holders of shares of Common Stock Equivalents without interest.

(e) Any portion of the Merger Consideration deposited with the Exchange Agent pursuant to this Section 1.5 (the "Exchange Fund") which remains undistributed to the holders of the Certificates for six months after the Effective Time shall be delivered to Buyer, upon demand, and any holders of shares of Common Stock Equivalents prior to the Merger who have not theretofore complied with this Article I shall thereafter look for payment of their claim, as general creditors thereof, only to Buyer for their claim for (1) cash, if any, without interest, (2) Buyer Shares, if any, (3) any cash without interest, to be paid, in lieu of any fractional Buyer Shares and (4) any dividends or other distributions with respect to Buyer Shares to which such holders may be entitled. None of Buyer, Acquisition Sub, the Company, the Surviving Corporation or the Exchange Agent shall be liable to any Person in respect of any Buyer Shares or cash held in the Exchange Fund (and any cash, dividends and other distributions payable in respect thereof) delivered to a public official pursuant to any applicable abandoned property, escheat or similar law.

(f) None of Buyer, Acquisition Sub, the Company, the Surviving Corporation or the Exchange Agent shall be liable to any Person in respect of any Buyer Shares or cash held in the Exchange Fund (and any cash, dividends and other distributions payable in respect thereof) delivered to a public official pursuant to any applicable abandoned property, escheat or similar law. If any Certificates shall not have been surrendered prior to one year after the Effective Time (or immediately prior to such earlier date on which (i) any cash, (ii) any Buyer Shares, (iii) any cash in lieu of fractional Buyer Shares or (iv) any dividends or distributions with respect to Buyer Shares in respect of such Certificate would otherwise escheat to or become the property of any Governmental Authority (as defined in Section 9.3 hereof)), any such Buyer Shares, cash, dividends or distributions in respect of such Certificate shall, to the extent permitted by applicable law, become the property of Buyer, free and clear of all claims or interest of any Person previously entitled thereto.

(g) The Exchange Agent shall invest any cash included in the

Exchange Fund, as directed by Buyer on a daily basis. Any interest and any other income resulting from such investments shall be paid to Buyer. Nothing contained in this Section 1.5(g) shall relieve Buyer or the Exchange Agent from making the payments required by this Article I to be made to the holders of shares of Common Stock Equivalents.

Section 1.6 Transfer Taxes; Withholding. If any certificate for a Buyer Share is to be issued to, or cash is to be remitted to, a Person who holds shares of Common Stock Equivalents (other than the Person in whose name the Certificate surrendered in exchange therefor is registered), it shall be a condition of such exchange that the Certificate so surrendered shall be properly endorsed and otherwise in proper form for transfer and that the Person requesting such exchange shall (i) pay to the Exchange Agent any transfer or other Taxes (as defined in Section 3.14 hereof) required by reason of the payment of the Merger Consideration to a Person other than the registered holder of the Certificate so surrendered, or (ii) establish to the satisfaction of the Exchange Agent that such Tax either has been paid or is not applicable. Buyer or the Exchange Agent shall be entitled to deduct and withhold from the Buyer Shares (or cash in lieu of fractional Buyer Shares) otherwise payable pursuant to this Agreement to any holder of shares of Common Stock Equivalents such amounts as Buyer or the Exchange Agent are required to deduct and withhold under the Code, or any provision of state, local or foreign Tax law, with respect to the making of such payment. To the extent that amounts are so withheld by Buyer or the Exchange Agent, such withheld amounts shall be treated for all purposes of this Agreement as having been paid to the holder of shares of Common Stock Equivalents in respect of whom such deduction and withholding was made by Buyer or the Exchange Agent.

Section 1.7 Stock Options and Other Stock.

(a) Prior to the Effective Time, Buyer and the Company shall take such action as may be necessary (including, without limitation, enacting such amendments, if any, to the Company Stock Plans (as hereinafter defined) as necessary to comply with the requirements of the Australian Stock Exchange ("ASX") or Australian Law; provided, however, that any such amendments shall not affect in any respect the number of Buyer Shares issuable upon exercise of Substituted Options (as defined below) or the exercise price thereof) to cause each unexpired and unexercised option to purchase shares of Common Stock which is outstanding immediately prior to the Effective Time (collectively, "Company Options"), to be automatically converted at the Effective Time into an option (collectively, a "Substituted Option") to purchase a number of Buyer Shares equal to the number of shares of Common Stock that could have been purchased under such Company Option multiplied by the Exchange Ratio in the case of the Forward Merger and by the product of one and two-thirds and the Reverse Merger Exchange Ratio in the case of the Reverse Merger (in each case, rounded to the nearest whole number of Buyer Shares) at a price per Buyer Share equal to the per-share option exercise price specified in the Company Option divided by the Exchange Ratio in the case of the Forward Merger and by the product of one and two-thirds and the Reverse Merger Exchange Ratio in the case of the Reverse Merger (in each case, rounded down to the nearest whole cent). Except as otherwise provided in this Agreement, such Substituted Option shall otherwise be subject to the same terms and conditions as were applicable to such Company Option, except as mandated by the requirements of the ASX or Australian Law; provided, however that clarification of the terms of the Substitute Options shall be made so as to make clear that, to the extent permitted by applicable law (without the need for obtaining additional Buyer shareholder approval), the optionee may use shares of capital stock of Buyer that have been held for six months by the option holder (including any period prior to the Effective Time during which such stock was stock of the Company) as payment of the exercise price thereof and in respect of the legally required withholding obligation. The date of the grant of the Substituted Option shall be the date on which the corresponding Company Option was granted and at the Effective Time all references in the related stock option agreements to the Company shall be deemed to refer to Buyer. Except as otherwise provided herein or in the applicable plan or program, employee deferrals and all other equity based compensation that reference Common Stock will, as of and after the Effective Time, be deemed to refer to Buyer Shares (as adjusted to reflect the Exchange Ratio or one and two-thirds multiplied by the Reverse Merger Exchange Ratio, as applicable). The adjustments provided for herein with respect to any options which are "incentive stock options" (as defined in Section 422 of the Code) shall be effected in a manner consistent with the requirements of Section 424(a) of the Code. Nothing contained herein shall alter or affect any provision providing for the accelerated vesting of Company Options in the event of a termination of employment following a "change in control" of the Company contained in any severance plans or employment agreements of the Company in effect as of the date hereof (or as may be amended pursuant to Section 6.12(e) and Section 6.12(e) of the Company Disclosure Schedule), as such terms are set forth in such plans or agreements, and Buyer agrees not to amend such provisions of any such plans following the Closing.

(b) Buyer shall take such corporate action as may be necessary or appropriate within two (2) business days following the Effective Time, file with the SEC a registration statement on Form S-8 (or any successor or other appropriate form) with respect to the Buyer Shares subject to the Substituted Options to the extent such registration is required under applicable law in order for such Buyer Shares to be sold without restriction in the United States, and Buyer shall use its reasonable best efforts to obtain and maintain the effectiveness of such registration statement for so long as such Substituted Options remain outstanding. Buyer shall promptly prepare and submit to the NYSE applications covering the Buyer Shares subject to the Substituted Options and use commercially reasonable efforts to cause such securities to be approved for listing on the NYSE prior to the Effective Time, subject to official notice of issuance, and within ten days after the Effective Time, prepare and submit to the ASX, pursuant to the applicable listing rules of the ASX, applications covering the Buyer Preferred Stock underlying the Buyer Shares to be issued upon the exercise of Substituted Options.

(c) Prior to the Effective Time, Buyer and the Company shall take all steps reasonably necessary to cause the transactions contemplated hereby and any other dispositions of equity securities of the Company (including derivative securities) or acquisitions of Buyer equity securities (including derivative securities) in connection with this Agreement by each individual who (a) is a director or officer of the Company or (b) at the Effective Time, will become a director or officer of Buyer, to be exempt under Rule 16b-3 promulgated under the Securities Exchange Act of 1934, as amended (the "Exchange Act") to the extent Section 16 of the Exchange Act is applicable to such person.

(d) At the time that a Substituted Option is exercised in accordance with the terms hereof, Buyer shall, pursuant to the terms of the Deposit Agreement, (x) deposit with the Custodian the shares of Buyer Preferred Stock underlying the Buyer Shares to be issued upon such exercise and (y) instruct the Depositary to deliver the Buyer Shares to be issued upon such exercise in accordance with the written instructions of the holder of such Substituted Option so exercised.

Section 1.8 Lost Certificates. If any Certificate shall have been lost, stolen or destroyed, upon the making of an affidavit of that fact by the Person claiming such Certificate to be lost, stolen or destroyed and, if required by the Surviving Corporation, the posting by such Person of a bond, in such reasonable amount as the Surviving Corporation may direct, as indemnity against any claim that may be made against it with respect to such Certificate, the Exchange Agent will issue in exchange for such lost, stolen or destroyed Certificate the Merger Consideration to which the holder thereof is entitled pursuant to this Article I.

Section 1.9 Dissenting Shares. Notwithstanding Section 1.2 hereof, to the extent that holders thereof are entitled to appraisal rights under Section 262 of Delaware Law, shares of Common Stock Equivalents issued and outstanding immediately prior to the Effective Time and held by a holder who has properly exercised and perfected his or her demand for appraisal rights under Section 262 of Delaware Law (the "Dissenting Shares"), shall not be converted into the right to receive the Merger Consideration, but the holders of Dissenting Shares shall be entitled to receive such consideration as shall be determined pursuant to Section 262 of Delaware Law; provided, however, that if any such holder shall have failed to perfect or shall have effectively withdrawn or lost his or her right to appraisal and payment under Delaware Law, such holder's shares of Common Stock Equivalents shall thereupon be deemed to have been converted as of the Effective Time into the right to receive the Merger Consideration, without any interest thereon, and such shares shall not be deemed to be Dissenting Shares. Any payments required to be made with respect to the Dissenting Shares shall be made by Buyer (and not the Company or Acquisition Sub).

Section 1.10Merger Closing. Subject to the satisfaction or, if permissible, waiver of the conditions set forth in Article VII hereof, the closing of the Merger (the "Closing") will take place at 9:00 a.m., New York City time, on a date determined in accordance with, in the case of the Forward Merger, the third sentence of Section 1.3(c) hereof and, in the case of the Reverse Merger, the proviso of the third sentence of Section 1.3(c) hereof, and in each case at the offices of Skadden, Arps, Slate, Meagher & Flom LLP, 4 Times Square, New York, New York, unless another time, date or place is agreed to in writing by the parties hereto (such date being the "Closing Date").

ARTICLE II

THE SURVIVING CORPORATION

Section 2.1 Certificate of Incorporation. The certificate of incorporation of Acquisition Sub in the case of the Forward Merger and the certificate of incorporation of the Company in the case of the Reverse Merger, in each case as in effect immediately prior to the Effective Time, shall be the certificate of incorporation of the Surviving Corporation until thereafter amended in accordance with applicable law; provided, however, in the case of the Reverse Merger, the certificate of incorporation of the Company shall be amended at the Effective Time to read in its entirety as the certificate of incorporation of Acquisition Sub, as in effect immediately prior to the Effective Time, then reads.

Section 2.2 By-laws. The By-laws of Acquisition Sub in effect at the Effective Time shall be the By-laws of the Surviving Corporation until thereafter amended in accordance with applicable law, the articles of formation of such entity and the By-laws of such entity.

Section 2.3 Officers and Board of Directors.

(a) From and after the Effective Time, the officers of the Acquisition Sub at the Effective Time shall be the officers of the Surviving Corporation, until their respective successors are duly elected or appointed and qualified in accordance with applicable law.

(b) The Board of Directors of the Surviving Corporation effective as of, and immediately following, the Effective Time shall consist of the members of the Board of Directors of Acquisition Sub immediately prior to the Effective Time.

ARTICLE III

REPRESENTATIONS AND WARRANTIES OF THE COMPANY

Except (i) as disclosed in the report on Form 10-K dated March 30, 2000 for the year ended December 31, 1999, the reports on Form 10-Q and Form 8-K since December 31, 1999 or the proxy statement dated April 5, 2000, in each case in the form filed by the Company with the SEC prior to the date of this Agreement or in such similar forms filed by the Company's subsidiaries for such periods or, to the extent it is readily apparent that such disclosure would be applicable hereto, in the disclosure schedules to the BHC Merger Agreement or the UTV Merger Agreement, (ii) as disclosed in a separate disclosure schedule which has been delivered by the Company to Buyer prior to the execution of this Agreement (the "Company Disclosure Schedule") (each section of which qualifies the correspondingly numbered representation and warranty or covenant to the extent specified therein and such other representations and warranties or covenants to the extent a matter in such section is disclosed in such a way as to make its relevance to the information called for by such other representation and warranty or covenant readily apparent) and (iii) (other than with respect to the representations of the Company set forth in Section 3.12(a) hereof, as to which this clause (iii) shall not be applicable) for the litigations and administrative proceedings set forth in Section 3.0 of the Company Disclosure Schedule (including claims made in relation thereto, the subject matter thereof and claims arising with respect thereto) and for any actions or omissions or alleged actions or omissions relating to or arising from environmental liabilities that are the subject matter of the litigations and administrative proceedings set forth in such Section 3.0 (including claims made in relation thereto, the subject matter thereof and claims arising with respect thereto) by (A) Montrose Chemical Corporation of California or (B) the Company (including its predecessors in interest, including, without limitation, Montrose Chemical Company and Baldwin-Montrose Chemical Company, Inc.) ("Excluded Matters"), the Company hereby represents and warrants to Buyer:

Section 3.1 Organization and Qualification; Subsidiaries.

(a) Each of the Company and its subsidiaries is a corporation or entity duly incorporated or formed, validly existing and in good standing under the laws of its jurisdiction of incorporation or formation and has the requisite corporate power and authority and all necessary governmental approvals to own, lease and operate its properties and to carry on its business as it is now being conducted, except where the failure to have such power, authority and governmental approvals would not, individually or in the aggregate, have a Company Material Adverse Effect (as defined below). Each of the Company and its subsidiaries is duly qualified or licensed as a foreign corporation to do business, and is in good standing, in each jurisdiction in which the character of the properties owned, leased or operated by it or the nature of its business makes such qualification or licensing necessary, except for such failures to be so qualified or licensed and in good standing as would not, individually or in the aggregate, have a Company Material Adverse Effect. The term "Company Material Adverse Effect" means any change, effect or circumstance that is or is reasonably likely to be materially adverse to the business, operations, results of operations or financial condition of the Company and its subsidiaries taken as a whole, other than any change, effect or circumstance relating to or resulting from (i) general changes in the television broadcasting industry, (ii) changes in general economic conditions or securities markets in general, or (iii) this Agreement or the transactions contemplated hereby or the announcement thereof.

(b) Other than with respect to Montrose Chemical Corporation of California (in which the Company owns a 50% equity interest and which is therefore not a subsidiary of the Company) and BHC and UTV (the capitalizations of which are described in Section 3.22 hereof) and their subsidiaries, all the outstanding shares of capital stock or other equity or voting interests of each subsidiary of the Company are owned by the Company, by another wholly owned subsidiary of the Company or by the Company and another wholly owned subsidiary of the Company, free and clear of all pledges, claims, liens, charges, encumbrances and security interests of any kind or nature whatsoever (collectively, "Liens"), and are duly authorized, validly issued, fully paid and nonassessable. Except as set forth above or in Section 3.1(b) of the Company Disclosure Schedule and except for the capital stock of, or other equity or voting interests in, its subsidiaries, the Company does not own, directly or indirectly, any capital stock of, or other equity or voting interests in, any corporation, partnership, joint venture, association or other entity.

Section 3.2 Restated Certificate of Incorporation and By-Laws. The Company has made available to Buyer a complete and correct copy of the Restated Certificate of Incorporation and the By-laws, each as amended to date, of the Company. The Restated Certificate of Incorporation and By-laws (or equivalent organizational documents) of the Company and its subsidiaries are in full force and effect. None of the Company or its subsidiaries is in material violation of any provision of its Restated Certificate of Incorporation or By-laws (or equivalent organizational documents).

Section 3.3 Capitalization. The authorized capital stock of the Company consists of 100,000,000 shares of Common Stock, 50,000,000 shares of Class B Common Stock, 73,399 shares of Prior Preferred Stock, no par value per share (the "Prior Preferred Stock"), 233,668 shares of Convertible Preferred Stock and 10,000,000 shares, par value $1.00 per share, of preferred stock (the "Preferred Stock"). As of the close of business on June 30, 2000, (i) 26,904,118 shares of Common Stock (excluding treasury shares) were issued and outstanding, (ii) no shares of Common Stock were held by the Company in its treasury, (iii) 5,033,732 shares of Common Stock were reserved for issuance pursuant to the Company 1999 Management Incentive Plan, the Company 1994 Management Incentive Plan and the Company 1994 Director Stock Option Plan (such plans, collectively, the "Company Stock Plans") (of which 3,693,992 shares were subject to outstanding Company Options), (iv) 8,395,525 shares of Common Stock were reserved for issuance upon conversion of the Convertible Preferred Stock, including shares of Class B Common Stock, (v) 8,013,860 shares of Common

Stock were reserved for issuance upon conversion of the Class B Common Stock, (vi) 8,013,860 shares of Class B Common Stock (excluding treasury shares) were issued and outstanding, (vii) no shares of Class B Common Stock were held by the Company in its treasury, (viii) no shares of Class B Common Stock were reserved for issuance pursuant to the Company Stock Plans, (ix) 73,399 shares of Prior Preferred Stock (excluding treasury shares) were issued and outstanding, (x) no shares of Prior Preferred Stock were held by the Company in its treasury, (xi) 233,668 shares of Convertible Preferred Stock (excluding treasury shares) were issued and outstanding and (xii) no shares of Convertible Preferred Stock were held by the Company in its treasury and (xiii) no shares of Preferred Stock were issued and outstanding or were held by the Company in its treasury. The redemption price of the Prior Preferred Stock is $25.00 per share plus accrued dividends for the period through and including September 30, 2000 in the amount of $0.25 per share. There are no outstanding stock appreciation rights or other rights that are linked to the price of Common Stock granted under any Company Stock Plan that were not granted in tandem with a related Company Option. No shares of Common Stock or Class B Common Stock or any other class of capital stock are owned by any subsidiary of the Company. The Company has delivered to Buyer a true and complete list, as of June 30, 2000, of all outstanding options to purchase Common Stock granted under the Company Stock Plans and all other rights, if any, to purchase or receive Common Stock granted under the Company Stock Plans, the number of shares subject to each such Company Option, the grant dates and exercise prices of each such Company Option and the names of the holder thereof. As of the date hereof, all outstanding Company Options have an exercise price on a per share basis lower than $85, and the weighted average exercise price of such Company Options was equal to $45.96. Except as set forth above and for the exercise of Company Options since June 30, 2000, as of the date of this Agreement, no shares of capital stock of, or other equity or voting interests in, the Company, or options, warrants or other rights to acquire any such stock or securities were issued, reserved for issuance or outstanding. During the period from June 30, 2000 to the date of this Agreement, (x) there have been no issuances by the Company of shares of capital stock of, or other equity or voting interests in, the Company other than (i) issuances of shares of Common Stock pursuant to the exercise of Company Options outstanding on such date, (ii) the issuance of shares of Common Stock and Class B Common Stock issued upon conversion of shares of Convertible Preferred Stock and (iii) the issuance of shares of Common Stock issued in exchange for shares of Class B Common Stock and (y) there have been no issuances by the Company of options, warrants or other rights to acquire shares of capital stock of, or other equity or voting interests in, the Company. All outstanding shares of capital stock of the Company are, and all shares that may be issued pursuant to the Company Stock Plans will be, when issued in accordance with the terms thereof, duly authorized, validly issued, fully paid and nonassessable and not subject to preemptive rights. There are no bonds, debentures, notes or other indebtedness for borrowed money of the Company or any of its subsidiaries, and, except as disclosed in this Section 3.3, no securities or other instruments or obligations of the Company or any of its subsidiaries the value of which is in any way based upon or derived from any capital or voting stock of the Company, having the right to vote (or convertible into, or exchangeable for, securities having the right to vote) on any matters on which stockholders of the Company may vote. Except as set forth above and except as specifically permitted under Section 5.1, there are no contracts of any kind to which the Company or any of its subsidiaries is a party or by which the Company or any of its subsidiaries is bound obligating the Company or any of its subsidiaries to issue, deliver or sell, or cause to be issued, delivered or sold, additional shares of capital stock of, or other equity or voting interests in, or securities convertible into, or exchangeable or exercisable for, shares of capital stock of, or other equity or voting interests in, the Company or any of its subsidiaries (other than BHC, UTV and their respective subsidiaries) or obligating the Company or any of its subsidiaries to issue, grant, extend or enter into any such security, option, warrant, call, right or contract. Except for the redemption of the Prior Preferred Stock contemplated by this Agreement, there are not any outstanding contractual obligations of the Company or any of its subsidiaries to (i) repurchase, redeem or otherwise acquire any shares of capital stock of, or other equity or voting interests in, the Company or any of its subsidiaries (other than BHC, UTV and their respective subsidiaries) or (ii) vote or dispose of any shares of the capital stock of, or other equity or voting interests in, any of its subsidiaries (other than BHC, UTV and their respective subsidiaries). To the knowledge of the Company, as of the date of this Agreement, there are no irrevocable proxies and no voting agreements with respect to any shares of the capital stock or other voting securities of the Company or any of its subsidiaries.

Section 3.4 Authority Relative to Agreement. The Company has all necessary power and authority to execute and deliver this Agreement, to perform its obligations hereunder and to consummate the Merger and the other transactions contemplated hereby. The execution and delivery of this Agreement by the Company and the consummation by the Company of the Merger and the other transactions contemplated hereby have been duly and validly authorized by all necessary corporate action and no other corporate proceedings on the part of the Company are necessary to authorize the execution and delivery of this Agreement or to consummate the Merger and the other transactions contemplated hereby (other than, with respect to the Merger, the adoption of this Agreement and the approval of the Merger by the affirmative vote of a majority of the votes cast by all stockholders entitled to vote at the Stockholders' Meeting (as defined in Section 6.2 hereof) voting together as a class, and the adoption of this Agreement and the approval of the Merger by the affirmative vote of the holders of the Convertible Preferred Stock, voting separately as a class (after giving effect to the redemption of the Prior Preferred Stock required pursuant to Section 5.2 hereof)). This Agreement has been duly and validly executed and delivered by the Company and, assuming the due authorization, execution and delivery by Buyer, this Agreement constitutes a legal, valid and binding obligation of the Company, enforceable against the Company in accordance with its terms.

Section 3.5 No Conflict; Required Filings and Consents.

(a) Except as set forth in Section 3.5 of the Company Disclosure Schedule, the execution and delivery of this Agreement by the Company do not, and the performance of this Agreement and the consummation of the Merger and the other transactions contemplated hereby by the Company and its subsidiaries will not, (i) conflict with or violate the Restated Certificate of Incorporation or By-Laws (or equivalent organizational documents) of (A) the Company or (B) any of its subsidiaries, (ii) assuming the consents, approvals and authorizations specified in Section 3.5(b) have been received and the waiting periods referred to therein have expired, and any condition precedent to such consent, approval, authorization, or waiver has been satisfied, conflict with or violate any domestic (Federal, state or local) or foreign law, rule, regulation, order, judgment or decree (collectively, "Laws") applicable to the Company or any of its subsidiaries or by which any property or asset of the Company or any of its subsidiaries is bound or affected or (iii) result in any breach of or constitute a default (or an event which with notice or lapse of time or both would become a default) under, or give to others any right of termination, amendment, acceleration, or cancellation of, or result in the creation of a lien or other encumbrance on any property or asset of the Company or any of its subsidiaries pursuant to, any note, bond, mortgage, indenture or credit agreement, or any other contract, agreement, lease, license, permit, franchise or other instrument or obligation to which the Company or any of its subsidiaries is a party or by which the Company or any of its subsidiaries or any property or asset of the Company or any of its subsidiaries is bound or affected, except, in the case of clauses (ii) and (iii) above, for any such conflicts, violations, breaches, defaults or other occurrences of the type referred to above which would not, individually or in the aggregate, have a Company Material Adverse Effect and would not prevent or materially delay the consummation of the Merger or the Subsidiary Mergers; provided, however, that for purposes of this Section 3.5(a), the definition of "Company Material Adverse Effect" shall be read so as not to include clause (iii) thereof.

(b) Except as set forth in Section 3.5 of the Company Disclosure Schedule, the execution and delivery of this Agreement by the Company do not, and the performance of this Agreement by the Company and the consummation of the Merger and the other transactions contemplated hereby by the Company and its subsidiaries will not, require any consent, approval, authorization, waiver or permit of, or filing with or notification to, any governmental or regulatory authority, domestic, foreign or supranational, except for applicable requirements of the Exchange Act, the Securities Act of 1933, as amended (the "Securities Act"), state securities or "blue sky" laws ("Blue Sky Laws"), the pre-merger notification arrangements of the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, and the rules and regulations thereunder (the "HSR Act"), any filings and approvals and waivers of the Federal Communications Commission or any successor entity (the "FCC") as may be required under the Communications Act of 1934, as amended, and the rules, regulations and published orders of the FCC thereunder (collectively, the "Communications Act"), filing and recordation of appropriate merger documents as required by Delaware Law and the rules of the NYSE and except where failure to obtain such consents, approvals, authorizations or permits, or to make such filings or notifications, would not, individually or in the aggregate, have a Company Material Adverse Effect and would not prevent or materially delay the consummation of the Merger or the Subsidiary Mergers; provided, however, that for purposes of this Section 3.5(b), the definition of "Company Material Adverse Effect" shall be read so as not to include clause (iii) thereof.

Section 3.6 Permits and Licenses; Contracts; Compliance with Laws.

(a) Each of the Company and its subsidiaries is in possession of all franchises, grants, authorizations, licenses, permits, easements, variances, exceptions, consents, certificates, approvals and orders necessary for the Company or any of its subsidiaries to own, lease and operate the properties of the Company and its subsidiaries or to carry on its business as it is now being conducted and contemplated to be conducted (the "Company Permits"), and no suspension or cancellation of any of the Company Permits is pending or, to the knowledge of the Company, threatened, except where the failure to have, or the suspension or cancellation of, any of the Company Permits would not, individually or in the aggregate, have a Company Material Adverse Effect. Except as set forth in Section 3.6(a) of the Company Disclosure Schedule, none of the Company or any of its subsidiaries is in conflict with, or in default or violation of, (i) any Laws applicable to the Company or any of its subsidiaries or by which any property or asset of the Company or any of its subsidiaries is bound or affected, (ii) any of the Company Permits or (iii) any note, bond, mortgage, indenture, contract, agreement, lease, license, permit, franchise or other instrument or obligation to which the Company or any of its subsidiaries is a party or by which the Company or any of its subsidiaries or any property or asset of the Company or any of its subsidiaries is bound or affected, except for any such conflicts, defaults or violations that would not, individually or in the aggregate, have a Company Material Adverse Effect.

(b) Except as set forth in Section 3.6(b) of the Company Disclosure Schedule, none of the Company or any of its subsidiaries is a party to, or to the knowledge of the Company is bound by, any contract or agreement that contains a covenant restricting the ability of the Company or any of its subsidiaries or, after the Effective Time, could restrict the ability of Buyer or any of its subsidiaries or affiliates, to compete in any line of business or with any person or engage in any business in any geographic area.

(c) The Company and its subsidiaries have operated their respective television stations and associated facilities (the "Company Stations"), in compliance with the terms of the Company Permits issued by the FCC to the Company and its subsidiaries ("Company FCC Licenses"), and in compliance with the Communications Act, and the Company and its subsidiaries have timely filed or made all applications, reports and other disclosures required by the FCC to be filed or made with respect to the Company Stations and have timely paid all FCC regulatory fees with respect thereto, in each case except as, individually or in the aggregate, (i) as of the date of this Agreement, would not materially adversely affect the operation of any of the broadcasting facilities of the Company subsidiaries' New York, Los Angeles, San Francisco or Minneapolis television stations and would not have a Company Material Adverse Effect and (ii) would not result in the loss of the Company subsidiaries' main station license issued by the FCC with respect to any of the Company's New York, Los Angeles, San Francisco or Minneapolis television stations and would not have a Company Material Adverse Effect. (i) There is not, as of the date of this Agreement, pending or, to the Company's knowledge, threatened before the FCC any material proceeding, notice of violation, order of forfeiture or complaint or, to the knowledge of the Company, investigation against the Company or any of its subsidiaries, relating to any of the Company Stations or FCC regulated services conducted by the Company or any of its subsidiaries and (ii) there is not pending or, to the Company's knowledge, threatened before the FCC any proceeding, notice of violation, order of forfeiture or complaint or, to the knowledge of the Company, investigation against the Company or any of its subsidiaries, relating to any of the Company Stations or FCC regulated services conducted by the Company or any of its subsidiaries, except for any such proceedings, notices, orders, complaints or investigations that would not, individually or in the aggregate, have a Company Material Adverse Effect.

(d) Except as disclosed in Section 3.6(d) of the Company Disclosure Schedule, as of the date of this Agreement, there are no contracts or agreements that are material to the business, properties, assets, condition (financial or otherwise) or results of operations of the Company and its subsidiaries taken as a whole. Neither the Company nor any of its subsidiaries is in violation or default of, nor has the Company or, to the knowledge of the Company, any subsidiary or affiliate thereof received written notice from any third party alleging that the Company or any of its subsidiaries is in violation of or in default under, nor, to the knowledge of the Company, does there exist any condition which upon the passage of time or the giving of notice would cause such a violation of or default under any loan or credit agreement, note, bond, mortgage, indenture, lease, permit, concession, franchise, license or any other contract, agreement, arrangement or understanding, to which it is a party or by which it or any of its properties or assets is bound, except for any such violations or defaults which would not, individually or in the aggregate, have a Company Material Adverse Effect and would not prevent or materially delay the consummation of the Merger or the Subsidiary Mergers.

(e) Set forth in Section 3.6(e) of the Company Disclosure Schedule is a list, as of the date of this Agreement, of all (i) network affiliation agreements, (ii) employment agreements involving payments in excess of $100,000 per annum or $300,000 in the aggregate, (iii) talent agreements involving payments in excess of $250,000 per annum or $500,000 in the aggregate, (iv) program or film syndication or license agreements requiring remaining payments after the date hereof of more than $500,000 per annum or $2,500,000 in the aggregate or, in the case of barter agreements, having a term ending more than one year from the date hereof, (v) retransmission consent agreements entered into with any direct satellite providers and each of the top 10 (ranked by number of subscribers) multiple system operators, and (vi) agreements licensing or creating any obligations with respect to the current or future use of the digital data stream of any digital television ("DTV") station owned or to be constructed by the Company or any of its subsidiaries that would be in effect following the Effective Time, to which, in each case, the Company or any of its subsidiaries is a party, and the Company has made available to Buyer true and complete copies of the agreements described in this Section 3.6(e). Also set forth in Section 3.6(e) of the Company Disclosure Schedule are the most recent syndicated program and feature film inventory reports for each of the Company Stations.

(f) Section 3.6(f) of the Company Disclosure Schedules sets forth a list, as of the date of this Agreement, of all material licenses and construction permits held by the Company with respect to the construction and operation of DTV stations in each of the markets in which the Company and its subsidiaries operate broadcast television stations (the "DTV Stations"). Except as set forth in Section 3.6(f) of the Company Disclosure Schedule, to the knowledge of the Company, there are no facts or circumstances existing as of the date of this Agreement that would prevent the construction and operation of the DTV Stations by the relevant deadline established by the FCC.

(g) Set forth in Section 3.6(g) of the Company Disclosure Schedule is a list of all attributable interests, as defined at Note 2 to 47 C.F.R. Section 73.3555, of the Company and its subsidiaries in any broadcast radio or television station, daily English-language newspaper or cable television system.

Section 3.7 SEC Reports. The Company, BHC and UTV have filed with the SEC, and have heretofore made available to Buyer true and complete copies of, all forms, reports, schedules, statements and other documents required to be filed with the SEC by the Company, BHC and UTV since January 1, 1997 (together with all information incorporated therein by reference, the "Company SEC Reports"). Except for BHC and UTV, no subsidiary of the Company is required to file any form, report, schedule, statement or other document with the SEC. As of their respective dates, the Company SEC Reports complied in all material respects with the requirements of the Securities Act or the Exchange Act, as the case may be, and the rules and regulations of the SEC promulgated thereunder applicable to such Company SEC Reports, and none of the Company SEC Reports at the time they were filed contained any untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary in order to make the statements therein, in light of the circumstances under which they were made, not misleading. The financial statements (including the related notes) included in the Company SEC Reports comply as to form in all material respects with applicable accounting requirements and the published rules and regulations of the SEC with respect thereto, have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") (except, in the case of unaudited statements, as permitted by Form 10-Q of the SEC) applied on a consistent basis during the periods involved (except as may be indicated in the notes thereto) and fairly present in all material respects the consolidated financial position of the Company, BHC and UTV and their respective consolidated subsidiaries as of the dates thereof and their respective consolidated results of operations and cash flows for the periods then ended (subject, in the case of unaudited statements, to normal and recurring year-end audit adjustments). Except as and to the extent set forth in Section 3.7 of the Company Disclosure Schedule, the Company and its subsidiaries do not have any liability or obligation of any nature (whether accrued, absolute, contingent or otherwise) other than liabilities and obligations which would not, individually or in the aggregate, have a Company Material Adverse Effect.

Section 3.8 Absence of Certain Changes or Events. Since December 31, 1999, except as contemplated by this Agreement, there has not been any change, event or circumstance which, when taken individually or together with all other changes, events or circumstances, has had or would have a Company Material Adverse Effect, including, to the extent covered by the definition of such term set forth in Section 3.1 hereof, any adverse effect on the Company's investment in BHC or BHC's investment in UTV, and (b) since December 31, 1999 to the date of this Agreement, (i) each of the Company and its subsidiaries has conducted its businesses only in the ordinary course and in a manner consistent with past practice and (ii) there has not been (A) any material change by the Company or any of its subsidiaries in its material accounting policies, practices and procedures, (B) any entry by the Company or any of its subsidiaries into any commitment or transaction material to the Company and its subsidiaries taken as a whole other than in the ordinary course of business consistent with past practice, (C) any declaration, setting aside or payment of any dividend or distribution in respect of any capital stock of the Company or any of its subsidiaries (other than cash dividends payable by any wholly owned subsidiary to another subsidiary or the Company or regular cash dividends on the Convertible Preferred Stock or Prior Preferred Stock or the UTV regular annual cash dividend paid in April 2000 or the BHC special dividend which was paid in January 2000), (D) any increase in the compensation payable or to become payable to any corporate officers or heads of divisions of the Company or any of its subsidiaries, except in the ordinary course of business consistent with past practice, or (E) any action, event, occurrence or transaction that would have been prohibited by Section 5.1 hereof if this Agreement had been in effect since December 31, 1999.

Section 3.9 Absence of Litigation. Except as disclosed in Section 3.9 of the Company Disclosure Schedule, there is no claim, action, proceeding or investigation pending or, to the knowledge of the Company, threatened against the Company or any of its subsidiaries, or any property or asset of the Company or any of its subsidiaries, before any court, arbitrator or Governmental Authority, in each case except as would not, individually or in the aggregate, have a Company Material Adverse Effect. None of the Company, any of its subsidiaries nor any property or asset of the Company or any of its subsidiaries is subject to any order, writ, judgment, injunction, decree, determination or award imposed by any court, arbitration or Governmental Authority, in each case except as would not, individually or in the aggregate, have a Company Material Adverse Effect.

Section 3.10 Employee Benefit Plans.

(a) Section 3.10(a) of the Company Disclosure Schedule lists each employee benefit plan, program, arrangement and contract (including, without limitation, any "employee benefit plan," as defined in Section 3(3) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA") and any "multiemployer plans" within the meaning of Section 3(37) of ERISA ("Multiemployer Plans")), maintained, contributed or required to be contributed to by the Company or any of its subsidiaries, or with respect to which the Company or any of its subsidiaries could incur liability under Section 4069 of ERISA (the "Company Benefit Plans"). No Company Benefit Plan has ever been or is currently subject to or governed by the Laws of any jurisdiction other than the United States or any State or Commonwealth of the United States. The Company has provided to Buyer a true and correct copy of each of the following documents, including any amendments thereto, with respect to each Company Benefit Plan, other than Multiemployer Plans: (i) the most recent annual report (Form 5500) filed with the Internal Revenue Service (the "IRS"), (ii) all plan documents for such Company Benefit Plan, (iii) each trust agreement, insurance contract or other funding vehicle relating to such Company Benefit Plan, (iv) the most recent summary plan description for each Company Benefit Plan for which a summary plan description is required, (v) the most recent actuarial report or valuation relating to a Company Benefit Plan subject to Title IV of ERISA, if any, and (vi) the most recent determination letter, if any, issued by the IRS with respect to any Company Benefit Plan qualified under Section 401(a) of the Code or voluntary employees' benefit association ("VEBA") qualified under Section 501(c)(9) of the Code. Except as specifically provided in the foregoing documents delivered to Buyer or except as otherwise contemplated by this Agreement or except as disclosed in Section 3.10(a) of the Company Disclosure Schedule, there are no amendments to any Company Benefit Plan that have been adopted or approved nor has the Company or any of its subsidiaries undertaken to make any such amendments or to adopt or approve any new Plan. The Company will, promptly following the date of this Agreement, request a copy of each Company Benefit Plan that is a multiemployer plan within the meaning of Section 3(37) of ERISA from the trustees of such multiemployer plan and the Company shall deliver such copy of the plan to Buyer promptly upon its receipt thereof.

(b) Each Company Benefit Plan has been administered in accordance with its terms and the terms of any applicable collective bargaining or other labor union contract or agreement, and in compliance with applicable laws. The Company and its subsidiaries have performed all obligations required to be performed by them under, are not in any respect in default under or in violation of, and have no knowledge of any default or violation by any party to, any Company Benefit Plans, except for any defaults or violations which would not, individually or in the aggregate, have a Company Material Adverse Effect. With respect to the Company Benefit Plans, no event has occurred and no condition or set of circumstances exists, in connection with which the Company or any of its subsidiaries is subject to any liability under the terms of such Company Benefit Plans, ERISA, the Code or any other applicable Law except as would not, individually or in the aggregate, have a Company Material Adverse Effect. No Company Benefit Plan (other than a Multiemployer Plan) is under audit or investigation by any Governmental Authority nor has the Company or any subsidiary been notified of any audit or investigation. Neither the Company nor any member of the same "controlled group" (as defined in Section 414(b), (e), (m) or (o) of the Code or Section 4001 of ERISA) as the

Company or any of its subsidiaries (collectively, the "ERISA Affiliates") has any actual or contingent liability under Title IV of ERISA (other than the payment of premiums to the Pension Benefit Guaranty Corporation), including, without limitation, any liability in connection with (i) the termination or reorganization of any employee benefit plan subject to Title IV of ERISA or (ii) the withdrawal from any Multiemployer Plan or Multiple Employer Plan (within the meaning of Section 4001(a)(3) and 4063, respectively, of the Code), and no fact or event exists which is reasonably likely to give rise to any such liability, in each case except as would not, individually or in the aggregate, have a Company Material Adverse Effect.

(c) The Company has made available to Buyer: (i) copies of all employment agreements with executive officers of the Company and its subsidiaries; (ii) copies of all severance agreements, programs and policies of the Company or any of its subsidiaries with or relating to its or its subsidiaries' employees; and (iii) copies of all plans, programs, agreements and other arrangements of the Company or any of its subsidiaries with or relating to its or its subsidiaries' employees which contain change in control provisions. Except as disclosed in Section 3.10(c) or Section 6.12(e) of the Company Disclosure Schedule, or except as otherwise contemplated by this Agreement neither the execution and delivery of this Agreement nor the consummation of the transactions contemplated hereby will (i) result in any payment (including, without limitation, severance, unemployment compensation, "golden parachute" or otherwise) becoming due to any director, officer or employee of the Company or any of its subsidiaries from the Company or any of its affiliates under any Company Benefit Plan or otherwise, (ii) materially increase any benefits otherwise payable under any Company Benefit Plan, (iii) result in any acceleration of the time of payment or vesting of any material benefits, (iv) result in a restriction on Buyer's ability to amend, modify or terminate any plan, (v) trigger a requirement for funding or the acceleration of funding of any material benefits, (vi) commence a period during which a subsequent termination of employment by an employee of the Company will entitle such employee to benefits in excess of what would otherwise have been required in the absence of the transactions contemplated hereby or (vii) result in a reportable event within the meaning of Section 4043(c) of ERISA for which a notice requirement has not been waived. Except as contemplated hereby, or as otherwise disclosed in Sections 3.10(c) or 6.12(e) of the Company Disclosure Schedule, the Company has taken no action with respect to the Company Options that would result in any acceleration of vesting of the Company Options in connection with the execution and delivery of this Agreement or the consummation of any transactions contemplated hereby or otherwise. Without limiting the generality of the foregoing, except as set forth in Section 3.10(c) or Section 6.12(e) of the Company Disclosure Schedule, no amount paid or payable by the Company to any employee of the Company or any of its subsidiaries in connection with the transactions contemplated hereby (either solely as a result thereof or as a result of such transactions in conjunction with any other event) will be an "excess parachute payment" within the meaning of Section 280G of the Code.

(d) Each Company Benefit Plan that is intended to be qualified under Section 401(a) of the Code or Section 401(k) of the Code has timely received a favorable determination letter from the IRS covering all of the provisions applicable to the Plan for which determination letters are currently available that the Company Benefit Plan is so qualified and each trust established in connection with any Company Benefit Plan which is intended to be exempt from Federal income taxation under Section 501(a) of the Code has received a determination letter from the IRS that it is so exempt, and no fact or event has occurred since the date of such determination letter or letters from the IRS which is reasonably likely to adversely affect the qualified status of any such Company Benefit Plan or the exempt status of any such trust. Each Company Benefit Plan that is a VEBA meets the requirements of Section 501(c)(9) of the Code.

(e) Except as set forth in Section 3.10(e) of the Company Disclosure Schedule, the Company and its subsidiaries have no liability for life, health, medical or other welfare benefits to former officers, directors or employees or beneficiaries or dependents thereof, except for health continuation coverage as required by Section 4980B of the Code or Part 6 of Title I of ERISA.

(f) There are no pending or threatened claims (other than claims for benefits in the ordinary course), lawsuits or arbitrations which have been asserted or instituted, or to Company's knowledge, no set of circumstances exists which may reasonably give rise to a claim or lawsuit, against the Company Benefit Plans, any fiduciaries thereof with respect to their duties to the Plans or the assets of any of the trusts under any of the Company Benefit Plans which could reasonably be expected to result in any liability of the Company or any of the ERISA Affiliates to the Pension Benefit Guaranty Corporation, the Department of Treasury, the Department of Labor, any Multiemployer Plan, any Company Benefit Plan or any participant in a Company Benefit Plan.

(g) The Company has taken reasonable steps to ensure that each individual classified by the Company or any subsidiary as an independent contractor has been properly classified as such.

Section 3.11 Labor Matters. There is no labor dispute, strike, work stoppage or lockout, or, to the knowledge of the Company, threat thereof, by or with respect to any employee of the Company or any of its subsidiaries, except where such dispute, strike, work stoppage or lockout individually or in the aggregate would not have a Company Material Adverse Effect. None of the Company or any of its subsidiaries has breached or otherwise failed to comply with any provision of any collective bargaining or other labor union contract applicable to any employees of the Company or any of its subsidiaries and there are no grievances or complaints outstanding or, to the knowledge of the Company, threatened against the Company or any of its subsidiaries under any such contract except for any breaches or failures to comply that, individually or in the aggregate, would not have a Company Material Adverse Effect.

Section 3.12 Environmental Matters.

(a) Notwithstanding clause (iii) of the introductory paragraph to Article III hereof, the Company represents and warrants to Buyer that prior to the date of this Agreement none of the persons set forth on Section 3.12(a) of the Company Disclosure Schedule have knowingly made to Buyer any materially false statements with respect to any material fact relating to Excluded Matters; provided, however, that the foregoing representation shall not apply to any opinions, estimates, predictions, projections, valuations or matters of judgment (collectively, "Opinions") made with respect to Excluded Matters, except to the extent any such Opinion was made by such specified persons with the willful intent to deceive Buyer.

(b) Except as would not, individually or in the aggregate, have a Company Material Adverse Effect:

(A) the Company and its subsidiaries (i) are in compliance with all, and, to the Company's knowledge, are not subject to any asserted liability or liability (including liability with respect to current or former subsidiaries or operations), in each case with respect to any Environmental Laws (as defined below), (ii) hold or have applied for all Environmental Permits (as defined below) and (iii) are in compliance with their respective Environmental Permits;

(B) neither the Company nor any Company subsidiary has received any written notice, demand, letter, claim or request for information alleging that the Company or any of its subsidiaries or, to the Company's knowledge as of the date of this Agreement, any of their predecessors in interest, is or may be in violation of, or liable under, any Environmental Law;

(C) (i) neither the Company nor any of its subsidiaries has entered into or agreed to any consent decree or order or is subject to any judgment, decree or judicial order relating to compliance with Environmental Laws, Environmental Permits or the investigation, sampling, monitoring, treatment, remediation, removal or cleanup of Hazardous Materials (as defined below) and, to the knowledge of the Company, no investigation, litigation or other proceeding is pending or threatened in writing with respect thereto, and (ii) neither the Company nor any of its subsidiaries nor, to the knowledge of the Company as of the date of this Agreement, any of their predecessors in interest, is an indemnitor in connection with any threatened or asserted claim by any third-party indemnitee or is the subject of a claim for personal injury or property damage for any liability under any Environmental Law or relating to any Hazardous Materials; and

(D) none of the real property owned or leased by the Company or any of its subsidiaries or, to the knowledge of the Company as of the date of this Agreement, any of their predecessors in interest, is listed or, to the knowledge of the Company, proposed for listing on the "National Priorities List" under CERCLA, as updated through the date hereof, or any similar state or foreign list of sites requiring investigation or cleanup. For purposes of this Agreement:

"CERCLA" means the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended as of the date hereof.

"Environmental Laws" means any applicable federal, state, local or foreign statute, law, ordinance, regulation, rule, code, treaty, writ or order and any enforceable judicial or administrative interpretation thereof, including any judicial or administrative order, consent decree, judgment, stipulation, injunction, permit, authorization, policy, opinion, or agency requirement, in each case having the force and effect of law, relating to the pollution, protection, investigation or restoration of the environment, health and safety or natural resources, including those relating to the use, handling, presence, transportation, treatment, storage, disposal, release, threatened release or discharge of Hazardous Materials or noise, odor, wetlands, pollution, contamination or any injury or threat of injury to persons or property or to the siting, construction, operation, closure and post-closure care of waste disposal, handling and transfer facilities.

"Environmental Permits" means any permit, approval, identification number, license and other authorization required under any Environmental Law.

"Hazardous Materials" means (i) any petroleum, petroleum products, by-products or breakdown products, radioactive materials, asbestos-containing materials or polychlorinated biphenyls and (ii) any chemical, material or other substance defined or regulated as toxic or hazardous or as a pollutant or contaminant or waste under any Environmental Law.

Section 3.13 Trademarks, Patents and Copyrights.

(a) Except as would not have a Company Material Adverse Effect, (i) the Company and its subsidiaries own, or possess necessary or required licenses, to be used in each case in the manner currently used, or other necessary or required rights to use, all patents, patent rights, trademarks, trademark rights, trade names, trade name rights, copyrights, domain names, service marks, service mark rights, trade secrets, applications to register, and registrations for, the foregoing trademarks, know-how and other proprietary rights and information (the "Intellectual Property Rights") used in connection with the business of the Company and its subsidiaries as currently conducted (the "Company Intellectual Property Rights"), and (ii) neither the Company nor any of its subsidiaries has received any written charge, complaint, claim, demand or notice challenging the validity of any of the Company Intellectual Property Rights.

(b) To the Company's knowledge, none of the Company or any of its subsidiaries has interfered with, infringed upon, misappropriated or otherwise come into conflict with any Intellectual Property Rights or other proprietary information of any other Person, except for any such interference, infringement, misappropriation or other conflict that, individually or in the aggregate, would not have a Company Material Adverse Effect. None of the Company or any of its subsidiaries has received any written charge, complaint, claim, demand or notice alleging any such interference, infringement, misappropriation or other conflict (including any claim that the Company or any of its subsidiaries must license or refrain from using any Company Intellectual Property Rights or other proprietary information of any other person) that has not been settled or otherwise fully resolved, except for any such interference, infringement, misappropriation or other conflict that, individually or in the aggregate, would not have a Company Material Adverse Effect. To the Company's knowledge, no other person has interfered with, infringed upon, misappropriated or otherwise come into conflict with any Company Intellectual Property Rights, except for any such interference, infringement, misappropriation or other conflict that, individually or in the aggregate, would not have a Company Material Adverse Effect.

Section 3.14 Taxes.

(a) For purposes of this Agreement, (i) "Tax" or "Taxes" means any and all taxes, fees, levies, duties, tariffs, imposts, and other charges of any kind (together with any and all interest, penalties, additions to tax and additional amounts imposed with respect thereto) imposed by any governmental or taxing authority including, without limitation: taxes or other charges on or with respect to income, franchises, windfall or other profits, gross receipts, property, sales, use, capital stock, payroll, employment, social security, workers' compensation, unemployment compensation, or net worth; taxes or other charges in the nature of excise, withholding, ad valorem, stamp, transfer, value added, or gains taxes; license, registration and documentation fees; and customs' duties, tariffs, and similar charges; and liability for the payment of any of the foregoing as a result of (x) being a member of an affiliated, consolidated, combined or unitary group, (y) being party to any tax sharing agreement and (z) any express or implied obligation to indemnify any other person with respect to the payment of any of the foregoing; and (ii) "Tax Returns" means returns, reports and information statements, including any schedule or attachment thereto, with respect to Taxes required to be filed with the IRS or any other governmental or taxing authority or agency, domestic or foreign, including consolidated, combined and unitary tax returns.

(b) Except as set forth in Section 3.14(b) of the Company Disclosure Schedule and except as would not, individually or in the aggregate, have a Company Material Adverse Effect (unless stated otherwise below): (i) each of the Company and each of its subsidiaries has timely filed all U.S. Federal, state, local and non-U.S. Tax Returns required to be filed by it, and all such Tax Returns are true, correct and complete, and has paid and discharged all Taxes shown as due thereon and has paid all of such other Taxes as are due, other than such payments as are being contested in good faith by appropriate proceedings; (ii) neither the IRS nor any other taxing authority or agency, domestic or foreign, is now asserting in writing or, to the knowledge of the Company or its subsidiaries after due inquiry, threatening in writing to assert against the Company or any of its subsidiaries any deficiency or claim with respect to Taxes of the Company or any of its subsidiaries; (iii) no waiver of any statute of limitations with respect to, or any extension of a period for the assessment of, any Tax has been granted by the Company or any of its subsidiaries without regard to whether such waiver or extension could have a Company Material Adverse Effect in connection with Federal, New York State and California Taxes; (iv) the accruals and reserves for Taxes reflected in the Company's audited consolidated balance sheet as of December 31, 1999 (and the notes thereto) (the "1999 Balance Sheet") and the most recent quarterly financial statements (and the notes thereto) are adequate to cover all Taxes accruable through the date thereof in accordance with generally accepted accounting principles; (v) no election under Section 341(f) of the Code has been made by the Company or any of its subsidiaries; (vi) the Company and each of its subsidiaries has withheld or collected and paid over to the appropriate governmental authorities or is properly holding for such payment all Taxes required by law to be withheld or collected; (vii) there are no liens for Taxes upon the assets of the Company or any of its subsidiaries, other than liens for Taxes that are being contested in good faith by appropriate proceedings or are not yet due, (viii) neither the Company nor any of its subsidiaries have constituted either a "distributing corporation" or a "controlled corporation" (within the meaning of Section 355(a)(1)(A) of the Code) in a distribution of stock qualifying for tax-free treatment under Section 355 of the Code in the two years prior to the date of this Agreement; (ix) the Federal income Tax Returns for the Company and each of its subsidiaries have been examined and settled with the IRS (or the applicable statutes of limitation for the assessment of Federal income Taxes for such periods have expired) for all years through 1995; (x) the Company and its subsidiaries have given or otherwise made available to Buyer correct and complete copies of (A) all Federal income Tax Returns of the Company, BHC and UTV filed for periods ending after December 31, 1993 and (B) income Tax returns filed on behalf of UTV of San Francisco, Inc. and affiliates for California and WWOR-TV, Inc. for New Jersey and New York State for tax years 1997 and 1998; (xi) neither the Company nor any of its subsidiaries are a party to any agreement relating to the sharing, allocation, or indemnification of

Taxes or any similar contract or arrangement without regard to whether any such agreement could have a Company Material Adverse Effect other than agreements between members of the affiliated group of which the Company is the common parent under Section 1504 of the Code; (xii) neither the Company nor any of its subsidiaries have agreed, or is required to make, any adjustment under Section 481 of the Code; (xiii) the Company and each of its subsidiaries were not, at any time during the period specified in Section 897(c)(1)(A)(ii) of the Code, a United States real property holding corporation within the meaning of Section 897(c)(2) of the Code without regard to whether such status could give rise to a Company Material Adverse Effect; and (xiv) there have been no redemptions by the Company or any of its subsidiaries since March 31, 1998 without regard to whether such redemptions could give rise to a Company Material Adverse Effect.

Section 3.15Tax Matters. None of the Company or any of its affiliates has taken or agreed to take any action, has failed to take any action or knows of any fact, agreement, plan or other circumstance that is reasonably likely to prevent the Merger from qualifying as a reorganization within the meaning of Section 368(a) of the Code; provided, however, that the foregoing representation is made only as of the date hereof in the case of the Reverse Merger. The preceding sentence excludes all transactions contemplated by this Agreement.

Section 3.16 Title to Properties; Assets. Neither the Company nor any of its subsidiaries owns, or has any material interest in, (i) any material assets in Australia or (ii) any television, media or other broadcasting assets in Australia. Except as set forth in Section 3.16 of the Company Disclosure Schedule and, in each case as, individually or in the aggregate, (i) as of the date of this Agreement, would not materially adversely affect the operation of the broadcasting facilities of the Company's subsidiaries' New York, Los Angeles, San Francisco or Minneapolis television stations and (ii) would not have a Company Material Adverse Effect:

(a) Each of the Company and its subsidiaries has good, marketable fee simple title to its owned properties and assets or good and valid leasehold interests in all of its leasehold properties and assets together with full legal and practical access to all of its properties except for such as are no longer used or useful in the conduct of its businesses or as have been disposed of in the ordinary course of business. All such properties and assets, other than properties and assets in which the Company or any of its subsidiaries has a leasehold interest, are free and clear of all Liens.

(b) Each of the Company and its subsidiaries has complied with the terms of all leases to which it is a party and under which it is in occupancy, and all deeds in respect of property which it owns, and all such leases and deeds are in full force and effect. Section 3.16(b) of the Company Disclosure Schedule sets forth a description of (i) each lease to which it is a party relating to its television broadcasting, (ii) all other leases to which it is a party in which the annual rental payments exceed $250,000 or which contemplate aggregate payments in excess of $500,000 and (iii) each deed under which it is the owner; and a copy of each such lease or deed, as applicable, has previously been provided to Buyer. The Company and its subsidiaries enjoy peaceful and undisturbed possession under all such leases. There are no facts that would prevent Buyer or any of its subsidiaries from using or occupying all of the leased and owned property referred to in clauses (i), (ii) and (iii) above, after the Effective Time, in the same manner such leased and owned property is used or occupied by the Company or its subsidiaries immediately prior to the Effective Time.

(c) The assets of the Company and each of its subsidiaries constitute all of the properties, assets and rights forming a part of, used, held or intended to be used in, and all such properties, assets and rights as are necessary in, the conduct of the business as it is now being conducted and contemplated to be conducted by the Company and its subsidiaries. At all times since December 31, 1999, each of the Company and its subsidiaries has caused such assets to be maintained in accordance with good business practice, and all of such assets are in good operating condition and repair and are suitable for the purposes for which they are used and intended.

Section 3.17 Year 2000 Compliance.

(a) The Company has adopted a plan that it believes will cause Company Systems (as defined below) to be Company Year 2000 Compliant (as defined below) (such plan, as it may be amended, modified or supplemented from time to time being, the "Company Year 2000 Plan") in all material respects. The Company has taken, and between the date of this Agreement and the Effective Time will continue to take, all reasonable steps to implement the Company Year 2000 Plan with respect to the Company Systems.

(b) For purposes of this Section 3.17, (i) "Company Systems" shall mean all computer, hardware, software, systems, and equipment (including embedded microcontrollers in non-computer equipment) embedded within or required to operate the current products of the Company and its subsidiaries, and/or material to or necessary for the Company and its subsidiaries to carry on their respective businesses as currently conducted; and (ii) "Company Year 2000 Compliant" means that Company Systems will (A) manage, accept, process, store and output data involving dates reasonably expected to be encountered in the foreseeable future and (B) accurately process date data from, into and between the 20th and 21st centuries and each date during the year 2000.

Section 3.18 Opinion of Financial Advisors. The Company has received the written opinion of Allen & Company Incorporated (the "Company Financial Advisor") on or prior to the date of this Agreement, to the effect that, as of the date of such opinion, the Merger Consideration is fair to the stockholders of the Company from a financial point of view, and the Company will deliver a copy of such opinion to Buyer promptly after the date of this Agreement.

Section 3.19 Vote Required. At the Stockholders' Meeting, the affirmative vote of a majority of the votes cast by all stockholders entitled to vote at the Stockholders' Meeting (including the holders of the Convertible Preferred Stock) voting together as a single class, and the majority vote of the holders of the Convertible Preferred Stock, voting as a separate class, are the only votes of the holders of any class or series of capital stock of the Company necessary to adopt this Agreement, after giving effect to the redemption of the Prior Preferred Stock required pursuant to Section 5.2 hereof.

Section 3.20 Brokers. The Company Financial Advisor has entered into a letter of engagement with the Company in connection with the Merger, a copy of which has previously been provided to Buyer. Except as disclosed in Section 3.20 of the Company Disclosure Schedule, no broker, finder or investment banker is entitled to any brokerage, finder's or other fee or commission in connection with the Merger based upon arrangements made by or on behalf of the Company other than as provided in a letter of engagement previously provided to Buyer.

Section 3.21 State Takeover Statutes. The Board of Directors of the Company has taken all action necessary to render inapplicable to the Merger and the transactions contemplated hereby the provisions of Section 203 of Delaware Law. To the knowledge of the Company, no other state takeover statute or similar statute or regulation applies or purports to apply to the Merger.

Section 3.22 BHC and UTV.

(a) As of the date of this Agreement, the authorized capital stock of (i) BHC consists of 200,000,000 shares of Class A Common Stock, par value $0.01 per share ("BHC Class A Shares"), 200,000,000 shares of Class B Common Stock, par value $0.01 per share ("BHC Class B Shares"), and 50,000,000 shares of Preferred Stock, par value $0.01 per share ("BHC Preferred Stock"), and (ii) UTV consists of 25,000,000 shares of Common Stock, par value $0.10 per share ("UTV Common Shares"), and 1,000,000 shares of Preferred Stock, par value $1.00 per share ("UTV Preferred Stock"). At the close of business on June 30, 2000, (i) 4,510,823 BHC Class A Shares were issued and outstanding, 18,000,000 BHC Class B Shares were issued and outstanding, no shares of BHC Preferred Stock were issued and outstanding, 9,486,173 UTV Common Shares were issued and outstanding and no shares of UTV Preferred Stock were issued and outstanding; (ii) (A) no shares were held by BHC in its treasury and (B) no shares were held by UTV in its treasury; and (iii) (X) no BHC Class A Shares and no BHC Class B Shares were reserved for issuance upon the exercise of outstanding options to purchase such shares and (Y) 234,570 UTV Common Shares were reserved for issuance upon the exercise of outstanding options to purchase such shares. Since January 31, 2000, no shares of capital stock of BHC or UTV have been issued except pursuant to exercise of options of UTV outstanding as of September 30, 1999 in accordance with the terms thereof. As of the date of this Agreement, except as set forth above, no shares of capital stock or other voting securities of BHC or UTV are issued, reserved for issuance or outstanding. As of the date of this Agreement, except as set forth above or in Section 3.22(a) of the Company Disclosure Schedule, there are no securities, options, warrants, calls, rights, commitments, agreements, arrangements or undertakings of any kind to which BHC or any of its subsidiaries or UTV or any of its subsidiaries is a party or by which any of them is bound obligating BHC or any of its subsidiaries or UTV or any of its subsidiaries to issue, deliver or sell, or cause to be issued, delivered or sold, additional shares of capital stock or other voting securities of BHC or any of its subsidiaries or UTV or of any of its subsidiaries or obligating BHC or any of its subsidiaries or UTV or any of its subsidiaries to issue, grant, extend or enter into any such security, option, warrant, call, right, commitment, agreement, arrangement or undertaking. All outstanding shares of capital stock of BHC and UTV are duly authorized, validly issued, fully paid and nonassessable and not subject to preemptive rights. There are no bonds, debentures, notes or other indebtedness of BHC, UTV or any of their respective subsidiaries, and no securities or other instruments or obligations of BHC, UTV or any of their respective subsidiaries the value of which is in any way based upon or derived from any capital or voting stock of BHC or UTV having the right to vote (or convertible into, or exchangeable for, securities having the right to vote) on any matters on which stockholders of BHC or UTV may vote. Except as set forth in Section 3.22(a) of the Company Disclosure Schedule, to the knowledge of the Company, as of the date of this Agreement, there are no outstanding contractual obligations of BHC or any of its subsidiaries or UTV or any of its subsidiaries (i) to repurchase, redeem or otherwise acquire any shares of capital stock of BHC or UTV or (ii) to vote or to dispose of any shares of the capital stock of any of BHC's or UTV's subsidiaries.

(b) As of the date of this Agreement (i) the Company, directly or indirectly, owns 10,000 BHC Class A Shares, 18,000,000 BHC Class B Shares and no shares of BHC Preferred Stock, and (ii) BHC directly or indirectly, owns 5,509,027 UTV Common Shares.

ARTICLE IV

REPRESENTATIONS AND WARRANTIES OF BUYER

Except as disclosed in its Annual Report on Form 20-F filed with the SEC on October 27, 1999, and the reports on Form 6-K filed with the SEC on November 3, 1999, February 15, 2000 and May 12, 2000, or in a separate disclosure schedule which has been delivered by Buyer to the Company prior to the execution of this Agreement (the "Buyer Disclosure Schedule") (each section of which qualifies the correspondingly numbered representation and warranty or covenant to the extent specified therein and such other representations and warranties or covenants to the extent a matter in such section is disclosed in such a way as to make its relevance to the information called for by such other representation and warranty or covenant readily apparent), Buyer hereby represents and warrants to the Company that:

Section 4.1 Organization and Qualification; Subsidiaries. Each of Buyer and its subsidiaries is a corporation or entity duly incorporated or formed, validly existing and, as applicable, in good standing, under the laws of its jurisdiction of incorporation or formation, and has the requisite corporate power and authority and all necessary governmental approvals to own, lease and operate its properties and to carry on its business as it is now being conducted, except where the failure to have such power, authority and governmental approvals would not, individually or in the aggregate, have a Buyer Material Adverse Effect (as defined below). Each of Buyer and its subsidiaries is duly qualified or licensed as a foreign corporation to do business, and is in good standing, in each jurisdiction where the character of the properties owned, leased or operated by it or the nature of its business makes such qualification or licensing necessary, except for such failures to be so qualified or licensed and in good standing that would not, individually or in the aggregate, have a Buyer Material Adverse Effect. The term "Buyer Material Adverse Effect" means any change, effect or circumstance that is or is reasonably likely to be materially adverse to the business, operations, results of operations or financial condition of Buyer and its subsidiaries taken as a whole, other than any change, effect or circumstance relating to or resulting from (i) general changes in the industry in which Buyer conducts business, (ii) changes in general economic conditions or securities markets in general or (iii) this Agreement or the transactions contemplated hereby or the announcement thereof.

Section 4.2 Charter Documents. Buyer has made available to the Company a complete and correct copy of the constitution, as amended to date, of Buyer. The constitution (or equivalent organizational documents) of Buyer and its subsidiaries are in full force and effect. Except as would not have a Buyer Material Adverse Effect, none of Buyer or its subsidiaries is in violation of any provision of its corporate charter documents (or equivalent organizational documents).

Section 4.3 Capitalization.

(a) No shares of capital stock of Buyer are owned by any subsidiary of Buyer. All outstanding shares of capital stock of Buyer are, when issued in accordance with the terms thereof, duly authorized, validly issued, fully paid and nonassessable and not subject to preemptive rights. There are no bonds, debentures, notes or other indebtedness of Buyer or any of its subsidiaries and no securities or other instruments or obligations of Buyer or any of its subsidiaries the value of which is in any way based upon or derived from any capital or voting stock of Buyer, having the right to vote (or convertible into, or exchangeable for, securities having the right to vote) on any matters on which stockholders of Buyer may vote. Except as set forth above, there are no contracts of any kind to which Buyer or any of its subsidiaries is a party or by which Buyer or any of its subsidiaries is bound obligating Buyer or any of its subsidiaries to issue, deliver or sell, or cause to be issued, delivered or sold, additional shares of capital stock of, or other equity or voting interests in, or securities convertible into, or exchangeable or exercisable for, shares of capital stock of, or other equity or voting interests in, Buyer or any of its subsidiaries or obligating Buyer or any of its subsidiaries to issue, grant, extend or enter into any such security, option, warrant, call, right or contract. There are not any outstanding contractual obligations of Buyer or any of its subsidiaries to (i) repurchase, redeem or otherwise acquire any shares of capital stock of, or other equity or voting interests in, Buyer or any of its subsidiaries or (ii) vote or dispose of any shares of the capital stock of, or other equity or voting interests in, any of its subsidiaries. To the knowledge of Buyer as of the date of this Agreement, there are no irrevocable proxies and no voting agreements with respect to any shares of the capital stock or other voting securities of Buyer or any of its subsidiaries.

(b) All shares of Buyer Preferred Stock underlying the Buyer Shares to be issued in the Merger, when deposited with the Custodian in accordance with Section 1.5(a) hereof and the terms of the Deposit Agreement, will be duly authorized, validly issued, fully paid and nonassessable and free and clear of all Liens. Upon the due issuance by the Depositary of Buyer Shares evidencing Buyer Preferred Stock against the deposit of Buyer Preferred Stock in accordance with the terms of the Deposit Agreement, the Buyer Shares to be issued in the Merger will be duly authorized, validly issued, fully paid and non-assessable and free and clear of all Liens and persons in whose names the Buyer Shares are registered will be entitled to the rights of registered holders of Buyer Shares specified therein and in the Deposit Agreement, and the Buyer Shares will conform in all material respects to the description of the Buyer Shares set forth in the proxy statement dated July 10, 1997 of Heritage Media Corporation, which proxy statement was incorporated by reference into the Registration Statement on Form F-4 of Buyer. The Deposit Agreement has been duly and validly authorized by all necessary corporate action of Buyer, has been duly and validly executed and delivered by Buyer, and constitutes the legal, valid and binding obligation of Buyer, enforceable against Buyer in accordance with its terms, except as enforcement may be limited by bankruptcy, insolvency, moratorium or other similar laws relating to creditors' rights generally and by equitable principles to which the remedies of specific performance and injunctive and similar forms of relief are subject.

Section 4.4 Authority Relative to Agreement. Buyer and its subsidiaries have all necessary power and authority to execute and deliver this Agreement, to perform their obligations hereunder and to consummate the Merger and the other transactions contemplated hereby. The execution and delivery of this Agreement by Buyer and the consummation by Buyer and certain of its subsidiaries of the Merger and the other transactions contemplated hereby have been duly and validly authorized by all necessary corporate action and no other corporate proceedings on the part of Buyer or any of its subsidiaries are necessary to authorize the execution and delivery of this Agreement or to consummate the Merger and the other transactions contemplated hereby (other than any necessary stockholder approval of Buyer (as provided in Section 4.5(b) hereof) or of any publicly owned subsidiaries of Buyer in connection with Section 6.18 hereof, which shall be obtained in accordance with Section 6.2(b) hereof). This Agreement has been duly and validly executed and delivered by Buyer and, assuming the due authorization, execution and delivery by the Company, this Agreement constitutes a legal, valid and binding obligation of Buyer, enforceable against Buyer in accordance with its terms. The Newco-FTH Agreement (as hereinafter defined), when executed and delivered by the parties thereto, will have been duly and validly executed and delivered by such parties and, will constitute a legal, valid and binding obligation of such parties, enforceable against such parties in accordance with its terms.

Section 4.5 No Conflict; Required Filings and Consents.

(a) The execution and delivery of this Agreement by Buyer does not, and the performance of this Agreement and the consummation of the Merger and the other transactions contemplated hereby by Buyer and its subsidiaries will not, (i) conflict with or violate the corporate charter documents (or equivalent organizational documents) of (A) Buyer or (B) any of its subsidiaries, (ii) assuming the consents, approvals and authorizations specified in Section 4.5(b) have been received and the waiting periods referred to therein have expired, and any condition precedent to such consent, approval, authorization, or waiver has been satisfied, conflict with or violate any Law or the Listing Rules (the "ASX Listing Rules") of the Australian Stock Exchange Limited ("ASX") applicable to Buyer or any of its subsidiaries or by which any property or asset of Buyer or any of its subsidiaries is bound or affected or (iii) result in any breach of or constitute a default (or an event which with notice or lapse of time or both would become a default) under, or give to others any right of termination, amendment, acceleration or cancellation of, or result in the creation of a lien or other encumbrance on any property or asset of Buyer or any of its subsidiaries pursuant to, any note, bond, mortgage, indenture or credit agreement, or, to Buyer's knowledge as of the date of this Agreement, any other, contract, agreement, lease, license, permit, franchise or other instrument or obligation to which Buyer or any of its subsidiaries is a party or by which Buyer or any of its subsidiaries or any property or asset of Buyer or any of its subsidiaries is bound or affected, except, in the case of clauses (i)(B), (ii) and (iii), for any such conflicts, violations, breaches, defaults or other occurrences of the type referred to above which would not have a Buyer Material Adverse Effect and would not prevent or materially delay the consummation of the Merger; provided, however, that for purposes of this Section 4.5(a), the definition of Buyer Material Adverse Effect shall be read so as not to include clause (iii) of the definition thereof.

(b) The execution and delivery of this Agreement by Buyer do not, and the performance of this Agreement by Buyer and the consummation of the Merger and the other transactions contemplated hereby by Buyer and its subsidiaries will not, require any consent, approval, authorization, waiver or permit of, or filing with or notification to, any Governmental Authority, except for applicable requirements of the Exchange Act, the Securities Act, Blue Sky Laws, the HSR Act, such filings and approvals as may be required under the Communications Act, filing and recordation of appropriate merger documents as required by Delaware Law, the rules of the NYSE filings and recordings of appropriate documents with, and announcements to, the Australian Securities and Investment Commission and the ASX, and a waiver from the ASX (or, if not obtained, the approval of Buyer's shareholders at a special meeting of Buyer shareholders (the "Buyer Shareholder Approval")) with respect to Listing Rule 10.1 of the ASX Listing Rules (the "ASX Waiver") and except where failure to obtain such consents, approvals, authorizations or permits, or to make such filings or notifications, would not have a Buyer Material Adverse Effect and would not prevent or materially delay the consummation of the Merger; provided, however, that for purposes of this Section 4.5(b), the definition of Buyer Material Adverse Effect shall be read so as not to include clause (iii) of the definition thereof.

Section 4.6 Permits and Licenses. Buyer or its subsidiaries have (i) operated the television stations and associated facilities for which Buyer or any of its subsidiaries holds licenses from the FCC, in each case which are owned or operated by Buyer or its subsidiaries (the "Buyer Licensed Facilities"), in compliance with the terms of the permits issued by the FCC to Buyer or its subsidiaries ("Buyer FCC Licenses"), and in compliance with the Communications Act, and (ii) timely filed or made all applications, reports and other disclosures required by the FCC to be filed or made with respect to the Buyer Licensed Facilities and have timely paid all FCC regulatory fees with respect thereto, in each case except as would not have a Buyer Material Adverse Effect. As of the date hereof, to Buyer's knowledge, there is not pending or threatened before the FCC any material investigation, proceeding, notice of violation, order of forfeiture or complaint against Buyer or any of its subsidiaries, relating to any of the Buyer Licensed Facilities or FCC regulated services conducted by Buyer or its subsidiaries that, if adversely decided, would have a Buyer Material Adverse Effect.

Section 4.7 Buyer SEC/ASX Reports. Buyer has filed with the SEC and ASX all forms, reports, schedules, statements and other documents required to be filed with the SEC and ASX by Buyer since January 1, 1997 (together with all information incorporated therein by reference, the "Buyer Reports"). As of their respective dates, the Buyer Reports complied in all material respects with the requirements of the Securities Act or the Exchange Act or the ASX Listing Rules, as the case may be, and the rules and regulations of the SEC promulgated thereunder applicable to such Buyer Reports, and none of the Buyer Reports at the time they were filed contained any untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary in order to make the statements therein, in light of the circumstances under which they were made, not misleading. The financial statements (including the related notes) of Buyer included in the Buyer Reports comply as to form in all material respects with applicable accounting requirements and the published rules and regulations of the SEC or the ASX with respect thereto, have been prepared in accordance with Australian generally accepted accounting principles with appropriate reconciliation to GAAP as required by SEC rules (except, in the case of unaudited statements, as permitted by forms or rules of the SEC) applied on a consistent basis during the periods involved (except as may be indicated in the notes thereto) and fairly present in all material respects the consolidated financial position of Buyer and its consolidated subsidiaries as of the dates thereof and their consolidated results of operations and cash flows for the periods then ended (subject, in the case of unaudited statements, to normal and recurring year-end audit adjustments). Buyer and its subsidiaries do not have any liability or obligation of any nature (whether accrued, absolute, contingent or otherwise) other than liabilities and obligations which, individually or in the aggregate, would not have a Buyer Material Adverse Effect.

Section 4.8 Absence of Certain Changes or Events.

(a) Since December 31, 1999, except as contemplated by this Agreement, there has not been any change, event or circumstance which, when taken individually or together with all other changes, events or circumstances, has had or would have a Buyer Material Adverse Effect, and (b) since December 31, 1999 to the date of this Agreement, each of Buyer and its subsidiaries has conducted its businesses only in the ordinary course and in a manner consistent with past practice.

Section 4.9 Tax Matters. None of Buyer or any of its affiliates has taken or agreed to take any action, has failed to take any action or knows of any fact, agreement, plan or other circumstance that is reasonably likely to prevent the Merger from qualifying as a reorganization within the meaning of Section 368(a) of the Code; provided, however, that the foregoing representation is made only as the date hereof in the case of the Reverse Merger. The preceding sentence excludes all transactions contemplated by this Agreement.

Section 4.10 Brokers. No broker, finder or investment banker (other than Donaldson, Lufkin & Jenrette, Inc.) is entitled to any brokerage, finder's or other fee or commission in connection with the Merger based upon arrangements made by or on behalf of Buyer or any subsidiary of Buyer.

Section 4.11 Interim Operations of Acquisition Sub. In the case of the Reverse Merger, Acquisition Sub will be a newly formed indirect subsidiary of Buyer, or a newly formed subsidiary of the Company, will be a Delaware corporation and, when formed, will have been formed solely for the purpose of engaging in the transactions contemplated hereby and the Subsidiary Mergers, as applicable, and will have engaged in no business other than in connection with such transactions and the transactions contemplated by this Agreement. In the case of the Forward Merger, Acquisition Sub will be News Publishing Australia Limited, a Delaware corporation, of which Buyer directly owns and will continue to own at least 80% of the total combined voting power of all classes of stock entitled to vote and 80% of the total number of shares of each other class of stock of such corporation.

ARTICLE V

CONDUCT OF BUSINESS PENDING THE MERGER

Section 5.1 Conduct of Business by the Company Pending the Merger. The Company covenants and agrees that, between the date of this Agreement and the Effective Time, except (x) as expressly contemplated by this Agreement (including, without limitation, as set forth in Section 5.1 of the Company Disclosure Schedule or as set forth as an exception or qualification to paragraphs (a) through (n) of this Section 5.1), (y) as expressly authorized pursuant to a Subsidiary Merger Agreement, and (z) as Buyer shall otherwise agree in advance in writing, the business of the Company and its subsidiaries shall be conducted only in, and the Company shall not take any action except in, the ordinary course of business and in a manner consistent with past practice; and the Company and its subsidiaries shall use their reasonable best efforts to preserve substantially intact the Company's business organization, to keep available the services of the current officers, employees and consultants of the Company and its subsidiaries (provided that the foregoing covenant to use reasonable best efforts shall not require or permit the Company to offer retention bonuses or other non-ordinary course compensation to such individuals without Buyer's written consent) and to preserve the current relationships of the Company and its subsidiaries with customers, distributors, dealers, suppliers and other persons with which the Company and its subsidiaries have significant business relations. By way of amplification and not limitation, between the date of this Agreement and the Effective Time, the Company will not do, and, subject to the fiduciary duties to BHC and UTV, as the case may be, of the Company, and, in the case of UTV, of BHC, and in either case, the members of the Boards of Directors of BHC and UTV, shall not permit any of its subsidiaries to do, directly or indirectly, any of the following except in compliance with the exceptions listed above:

(a) amend or otherwise change the Restated Certificate of Incorporation or By-laws of the Company or, in any material respect, that of any of its subsidiaries;

(b) issue, sell, pledge, dispose of, grant, encumber, or authorize the issuance, sale, pledge, disposition, grant or encumbrance of, (i) any shares of its or its subsidiaries' capital stock, or any options, warrants, convertible securities or other rights of any kind to acquire any shares of its or its subsidiaries' capital stock or any other ownership interest (including any phantom interest), of the Company or any of its subsidiaries (except for the issuance of shares issuable pursuant to any Company Options outstanding as of the date hereof), (ii) any assets except for sales of marketable securities and investment assets for their fair value and except for sales of other assets in the ordinary course of business consistent with past practice not in excess of $500,000 in the aggregate;

(c) declare, set aside, make or pay any dividend or other distribution, payable in cash, stock, property or otherwise, with respect to the Company's or any of its subsidiaries' capital stock (other than regular cash dividends in respect of the Company's Convertible Preferred Stock or the Prior Preferred Stock or cash dividends payable by any wholly owned subsidiary (or by BHC or UTV (if permitted under the BHC Merger Agreement or the UTV Merger Agreement)) with respect to ordinary course dividends, including dividends designated as special dividends, in a manner consistent with past practice);

(d) in the case of the Company, reclassify, combine, split, subdivide or redeem, purchase or otherwise acquire, directly or indirectly, any of its capital stock;

(e) (i) except in connection with acquisitions or investments which are made in the ordinary cause of business consistent with past practice not in excess of $10,000,000 individually or $25,000,000 in the aggregate and which the Buyer has not reasonably objected to as presenting any meaningful risk of resulting in the FCC Consent (with no Adverse Condition) not being obtained or delayed for more than an immaterial period of time and except with respect to the reinvestment of marketable securities or investment assets, and the investment of cash generated by the operations of the Company and its subsidiaries in marketable securities, in each case in the ordinary course of business consistent with past practice (A) acquire (including by merger, consolidation, or acquisition of stock or assets), or otherwise make any investment in, any corporation, partnership, limited liability company, other business organization or any division thereof, or any material amount of assets, or acquire any interest in any broadcast radio or television station, daily English-language newspaper or cable television system, as defined at Note

2 to 47 C.F.R. Section 73.3555; or (B) incur any indebtedness for borrowed money, issue any debt securities, assume, guarantee or endorse, or otherwise as an accommodation become responsible for, the obligations of any person, agree to amend or otherwise modify in any manner any agreement or instrument pursuant to which the Company has incurred indebtedness, or make any loans or advances, except in the ordinary course of business and consistent with past practice, except the refinancing of existing indebtedness, borrowings under commercial paper programs in the ordinary course of business or borrowings under existing bank lines of credit in the ordinary course of business, (ii) enter into any material contract, agreement or transaction, other than (X) in the ordinary course of business, and (Y) which would not be reasonably likely to prevent or materially delay the consummation of the Merger, (iii) authorize any capital expenditures which are, in the aggregate, in excess of 110% of the amounts currently budgeted for fiscal year 2000, and with respect to fiscal year 2001, in excess of 120% of the amount budgeted for fiscal year 2000, in each case for the Company and its subsidiaries taken as a whole; provided that any amounts budgeted in respect of DTV may be reallocated between the two years or (iv) enter into or amend any contract, agreement, commitment or arrangement which would require the Company to take any action prohibited by this subsection (e);

(f) except as set forth in Section 6.12 hereof or as required by Law or by the terms of any collective bargaining agreement or other labor union contract or other agreement currently in effect between the Company or any subsidiary of the Company and any executive officer or employee thereof (provided, however, that except as contemplated hereby no actions shall be taken with respect to the acceleration of vesting or cashing-out of Company Options in connection with the execution and delivery of this Agreement or the consummation of any transactions contemplated hereby or otherwise), increase the compensation payable or to become payable to its executive officers or employees, or grant any severance or termination pay to, or enter into any employment or severance agreement with, any director or executive officer or employee of it or any of its subsidiaries, or establish, adopt, enter into or amend in any respect or take action to accelerate any rights or benefits under any collective bargaining, bonus, profit sharing, thrift, compensation, stock option, restricted stock, pension, retirement, deferred compensation, employment, termination, severance or other plan, agreement, trust, fund, policy or arrangement for the benefit of any director, executive officer or employee, provided that this clause shall not prevent the Company or any of its subsidiaries from (i) making severance payments to the extent contractually obligated under contractual arrangements currently existing at the Company or such subsidiary and previously disclosed to Buyer, (ii) increasing compensation in accordance with the provisions of agreements with executive officers or employees in accordance with the terms of such agreements in effect on the date of this Agreement, provided that if any such agreement does not specify the amount of such increase, no such increase shall (A) fail to be in the ordinary course of business and in accordance with the past practices of the Company and (B) exceed 10 percent of the compensation of such executive officer or employee in effect on the date of this Agreement, or (iii) increasing compensation for employees who are not parties to agreements relating to compensation, provided that each such increase (A) is in the ordinary course of business, and in accordance with the past practices of the Company and (B) does not exceed, with respect to any employee, 10 percent of the compensation of such employee on the date of this Agreement; or (iv) taking any actions necessary and appropriate to effectuate the provisions of Section 6.12(e) of the Company Disclosure Schedule;

(g) change (except as required by the SEC or changes in GAAP which become effective after the date of this Agreement) any accounting methods, policies, practices or procedures;

(h) enter into any contract, agreement, lease, license, permit, franchise or other instrument or obligation which if in existence and known to the Company prior to the date of this Agreement would have resulted in a breach of Section 3.5 hereof;

(i) settle or compromise any material arbitration, action, suit, investigation or proceeding (other than those related to Tax matters, which shall be governed exclusively by the provisions of Section 5.4 hereof), other than any such matter which, if settled or compromised, would not be materially detrimental to the Company and its subsidiaries taken as a whole; provided, however that the Company shall not in any event settle any arbitration action, suit, investigation or proceeding arising out of this Agreement or the matters contemplated hereby without Buyer's consent (other than those related to Tax matters, which shall be governed exclusively by the provisions of Section 5.4 hereof);

(j) settle or discharge any material liability of a type not covered in subsection (i) above, other than in accordance with its terms or on terms no less favorable to the Company and its subsidiaries;

(k) amend or waive any right under or enter into any agreement with any affiliate of the Company (other than its wholly owned subsidiaries or BHC or UTV in the ordinary course of business consistent with past practice) or with any stockholder of the Company or any of its subsidiaries or any affiliate of any such stockholder;

(l) enter into, amend in any material respect or terminate any network affiliation agreement, retransmission consent agreement or, except in the case of agreements terminable without cost or penalty by the Company prior to the Closing or by Buyer within 30 days thereafter, any agreement licensing or creating any obligations with respect to the use of the digital data stream of any DTV Station;

(m) enter into, amend or terminate any film or program license or syndication agreement (each a "Program Agreement") involving aggregate payments of more than (i) $2,500,000 in the aggregate on a per Program Agreement, per station basis, (ii) $5,000,000 in the aggregate on a per station basis, (iii) $500,000 per annum on a per Program Agreement, per station basis and (iv) barter agreements that expire after December 31, 2001; or

(n) enter into or publicly announce an intention to enter into any contract, agreement, commitment or arrangement to, do any of the foregoing actions set forth in this Section 5.1.

Section 5.2 Prior Preferred Stock. The Company shall (i) take all actions required pursuant to the Restated Certificate of Incorporation to cause a notice (as defined in paragraph III.A(2) of Article Fourth of the Restated Certificate of Incorporation) of redemption to be mailed to the holders of the Prior Preferred Stock not less than 30 days prior to the date fixed for redemption which date shall be set by the Company to be no fewer than five (5) or greater than ten (10) days prior to the date set by the Company pursuant to Section 6.2 hereof for the Stockholders' Meeting and (ii) prior to the Stockholders' Meeting (a) cause the redemption price (as specified in the Restated Certificate of Incorporation) to be deposited with the redemption depository (as specified in the Restated Certificate of

Incorporation) and (b) take all necessary action to effectuate such redemption.

Section 5.3 FCC Matters. During the period from the date of this Agreement to the Effective Time, the Company shall, and shall cause each of its subsidiaries: (i) to use its reasonable best efforts to comply with all material requirements of the FCC applicable to the operation of the Company Stations; (ii) promptly to deliver to Buyer copies of any material reports, applications or responses filed with the FCC; (iii) promptly to notify Buyer of any inquiry, investigation or proceeding initiated by the FCC; (iv) not to make or revoke any material election with the FCC; and (v) use its reasonable best efforts to take all actions necessary to complete construction and initiate operation of the DTV Stations by the relevant deadline established by the FCC, as it may be extended, and to consult with Buyer about, and keep Buyer reasonably informed of, the progress of construction of the DTV Stations.

Section 5.4 Certain Tax Matters. During the period from the date of this Agreement to the Effective Time, the Company shall, and shall cause each of its subsidiaries to: (i) timely file all Tax Returns ("Post-Signing Returns") required to be filed by it and such Post-Signing Returns shall be prepared in a manner consistent with past practice; (ii) timely pay all Taxes due and payable in respect of such Post-Signing Returns that are so filed; (iii) accrue a reserve in its books and records and financial statements in accordance with past practice for all Taxes payable by it for which no Post-Signing Return is due prior to the Effective Time; (iv) promptly notify Buyer of any Federal, California, New Jersey or New York income or franchise tax and any other material suit, claim, action, investigation, proceeding or audit (collectively, "Actions") pending against or with respect to the Company or any of its subsidiaries in respect of any Tax matter, including (without limitation) Tax liabilities and refund claims, and not settle or compromise any such Tax matter or Action without Buyer's consent, which consent shall not be unreasonably withheld; and (v) not make or revoke any material Tax election or adopt or change a material tax accounting method without Buyer's consent.

ARTICLE VI

ADDITIONAL AGREEMENTS

Section 6.1 Registration Statement; Proxy Statement.

(a) As promptly as practicable after the execution of this Agreement, (i) the Company shall prepare and shall cause to be filed with the SEC a proxy statement (together with any amendments thereof or supplements thereto, the "Proxy Statement") relating to the meeting of the Company's stockholders to be held to consider the adoption of this Agreement and the approval of the Merger, (ii) Buyer shall prepare and file with the SEC a registration statement on the appropriate form (together with all amendments thereto, the "Share Registration Statement") in which the Proxy Statement shall be included as a prospectus, in connection with the registration under the Securities Act of the Buyer Shares to be issued to the stockholders of the Company pursuant to the Merger and (iii) Buyer shall prepare and file with the SEC a registration statement on the appropriate form (together with all amendments thereto, the "Option Registration Statement," and together with the Share Registration Statement, the "Registration Statement") in which the Proxy Statement will be included as a prospectus, in connection with the registration under the

Securities Act of the Buyer Shares to the issued upon exercise of the Substituted Options, it being understood that the Option Registration Statement shall be considered filed as promptly as practicable if it is filed by Buyer within at least two (2) business days following the Effective Time. In addition to the foregoing, Buyer shall make such other appropriate filings and deliveries as may be required by applicable law (including any applicable prospectus delivery requirements thereof). Each of Buyer and the Company shall use its reasonable best efforts to cause the Registration Statement to become effective at such time as they shall agree, and, prior to the effective date of the Registration Statement, Buyer shall use reasonable best efforts to take all or any action required under any applicable Federal or state securities Laws in connection with the issuance of Buyer Shares pursuant to the Merger. If requested by the SEC, each of the Forward Merger and the Reverse Merger shall be submitted to the Company's stockholders at the Stockholders' Meeting (as defined in Section 6.2) as separate proposals. Each of Buyer and the Company shall furnish all information concerning it as may reasonably be requested by the other party in connection with such actions and the preparation of the Proxy Statement and Registration Statement. As promptly as practicable after the Registration Statement shall have become effective, the Company shall mail the Proxy Statement to its stockholders. Each of Buyer and the Company shall also promptly file, use reasonable best efforts to cause to become effective as promptly as practicable and, if required, mail to the Company's stockholders, any amendment to the Registration Statement or Proxy Statement which may become necessary after the date the Registration Statement is declared effective.

(b) The Proxy Statement shall include the recommendation of the Board of Directors of the Company to the stockholders of the Company in favor of the adoption of this Agreement and the approval of the Merger; provided, however, that the Board of Directors of the Company may take or disclose to its stockholders a position contemplated by Rule 14e-2(a) promulgated under the Exchange Act or make any disclosure required under applicable Law and may, prior to the date of its Stockholders' Meeting (as defined in Section 6.2 hereof), withdraw, modify, or change any such recommendation to the extent that the Board of Directors of the Company determines in good faith that such withdrawal, modification or change is required in order to comply with its fiduciary duties under applicable Law after receiving advice to such effect from independent legal counsel (who may be the Company's regularly engaged outside legal counsel). Unless this Agreement is previously terminated in accordance with Article VIII, the Company shall submit this Agreement to its stockholders at its Stockholders' Meeting even if the Board of Directors of the Company determines at any time after the date hereof that is no longer advisable or recommends that the Company's stockholders reject it.

(c) No amendment or supplement to the Proxy Statement or the Registration Statement will be made by Buyer or the Company without the approval of the other party, which shall not be unreasonably withheld or delayed. Each of Buyer and the Company will advise the other, promptly after it receives notice thereof, of the time when the Registration Statement has become effective or any supplement or amendment has been filed, the issuance of any stop order, the suspension of the qualification of the Buyer Shares issuable in connection with the Merger for offering or sale in any jurisdiction, or any request by the SEC for amendment of the Proxy Statement or the Registration Statement or comments thereon and responses thereto or requests by the SEC for additional information.

(d) The information supplied by the Company for inclusion in the Registration Statement and the Proxy Statement (including by incorporation by reference) shall not, at (i) the time the Registration Statement is declared effective, (ii) the time the Proxy Statement (or any amendment thereof or supplement thereto) is first mailed to the stockholders of the Company, (iii) the time of the Stockholders' Meeting, and (iv) the Effective Time, contain any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary in order to make the statements therein not misleading. If at any time prior to the Effective Time any event or circumstance relating to the Company or any of its subsidiaries, or their respective officers or directors, should be discovered by the Company which, pursuant to the Securities Act or Exchange Act, should be set forth in an amendment or a supplement to the Registration Statement or Proxy Statement, the Company shall promptly inform Buyer. All documents that the Company is responsible for filing with the SEC in connection with the Merger will comply as to form in all material respects with the applicable requirements of the Securities Act and the Exchange Act.

(e) The information supplied by Buyer for inclusion in the Registration Statement and the Proxy Statement (including by incorporation by reference) shall not, at (i) the time the Registration Statement is declared effective, (ii) the time the Proxy Statement (or any amendment thereof or supplement thereto) is first mailed to the stockholders of the Company, (iii) the time of the Stockholders' Meeting, and (iv) the Effective Time, contain any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary in order to make the statements therein not misleading. If at any time prior to the Effective Time any event or circumstance relating to Buyer or any of its subsidiaries, or their respective officers or directors, should be discovered by Buyer which, pursuant to the Securities Act or Exchange Act, should be set forth in an amendment or a supplement to the Registration Statement or Proxy Statement, Buyer shall promptly inform the Company. All documents that Buyer is responsible for filing with the SEC in connection with the Merger will comply as to form in all material respects with the applicable requirements of the Securities Act and the Exchange Act.

Section 6.2 Stockholders' Meetings; Approvals.

(a) The Company shall, as promptly as practicable following the date of this Agreement, establish a record date (which will be set in accordance with Section 5.2 hereof and as promptly as reasonably practicable following the date of this Agreement) for, duly call, give notice of, convene and hold a meeting of its stockholders (the "Stockholders' Meeting"), for the purpose of voting upon the adoption of this Agreement and approval of the Merger, and the Company shall hold the Stockholders' Meeting as soon as practicable after the date on which the Registration Statement becomes effective. The Company shall use its reasonable best efforts to cause the Stockholders' Meeting to occur on the same day as the meetings of stockholders are held to consider the Subsidiary Mergers. The Company shall use its reasonable best efforts to solicit from its stockholders proxies in favor of the adoption of this Agreement and approval of the Merger, and shall take all other action necessary or advisable to secure the vote of its stockholders, required by the NYSE or Delaware Law, as applicable, to obtain such approvals; provided, however, that the Company shall not be obligated to solicit proxies in favor of the adoption of this Agreement at its Stockholders' Meeting (but shall nonetheless remain obligated to submit this Agreement to a vote of its stockholders) to the extent that the Board of Directors of the Company determines in good faith that such failure to solicit proxies is required in order to comply with its fiduciary duties under applicable Law after receiving advice to such effect from independent legal counsel (who may be such party's regularly engaged outside legal counsel).

(b) Without limiting the provisions of Section 4.4 hereof, Buyer shall, as promptly as practicable following the date of this Agreement, obtain, and cause its subsidiaries to obtain, all stockholder and other approvals, including the Buyer Shareholder Approval if required, necessary to consummate the Merger and the other transactions contemplated hereby, including, without limitation, entering into and performing the agreements and transactions contemplated by Section 6.18 hereof.

Section 6.3 Appropriate Action; Consents; Filings.

(a) Each of the parties hereto shall (i) make promptly its respective filings, and thereafter make any other required submissions under the HSR Act with respect to the transactions contemplated herein and (ii) make promptly filings with or applications to the FCC with respect to the transactions contemplated herein (the "FCC Application"). The parties hereto will use their respective reasonable best efforts to consummate and make effective the transactions contemplated herein and to cause the conditions to the Forward Merger and, if a Restructuring Trigger has occurred, the Reverse Merger, in each case as set forth in Article VII to be satisfied (including using reasonable best efforts to obtain all licenses, permits, consents, approvals, authorizations, waivers, qualifications and orders of Governmental Authorities as are necessary for the consummation of the transactions contemplated herein), and will do so in a manner designed to obtain such regulatory clearance and the satisfaction of such conditions as expeditiously as reasonably possible; provided, however, that Buyer and FTH shall have the right to make all decisions concerning any divestiture commitments necessary to comply with the FCC's multiple ownership rules set forth at 47 C.F.R. Section 73.3555 as in effect on the date of this Agreement (the "FCC Multiple Ownership Rules"); provided, that Buyer and FTH shall regularly consult with the Company during the processes referred to in this Section 6.3 and consider in good faith the views of the Company with respect thereto; and provided, further, that, in connection with the Merger, Buyer and FTH shall not seek a waiver of Section 73.3555 of the FCC's rules except for a temporary waiver of subsections (b) and (e) thereof for a period not to exceed twelve months from the Closing Date for television divestitures required in order to obtain the FCC Consent (as defined in Section 7.1(e) hereof) and, with respect to subsection (d) thereof in the FCC Application when it is filed, Buyer will (1) maintain that no waiver is required to permit it to own a newspaper and two television stations in the New York market, and (2) request in the alternative, if that position is rejected or a permanent waiver is not issued by the FCC, a temporary waiver to hold the two television stations and newspaper for a period not to extend beyond the date which is the later of (A) twelve months from the Closing Date and (B) the conclusion of any then pending FCC rule making proceeding regarding 47 CFR Section 73.3555(d); provided that the foregoing sentence shall be subject to the provisions of subsection (b) below. Failure to obtain any of the waivers set forth above shall not limit Buyer's obligations pursuant to subsection (b) below.

(b) Notwithstanding anything to the contrary in this Agreement other than the following sentence, the Company, Buyer and FTH each agree to take promptly any and all steps necessary to avoid or eliminate each and every impediment and obtain all consents or waivers under any antitrust, competition or communications or broadcast Law that may be validly required by any U.S. federal, state or local antitrust or competition Governmental Authority, or by the FCC or similar Governmental Authority, or by any Australian Law, in each case with competent jurisdiction, so as to enable the parties to close the transactions contemplated by this Agreement as expeditiously as reasonably possible, including committing to or effecting, by consent decree, hold separate orders, trust, or otherwise, the sale or disposition of such of its assets or businesses as are required to be divested in order to obtain the FCC Consent (as defined below), or to avoid the entry of, or to effect the dissolution of or vacate or lift, any decree, order, judgment, injunction, temporary restraining order or other order in any suit or proceeding by or with any Governmental Authority (each, an "Order"), that would otherwise have the effect of preventing or materially delaying the consummation of the Merger and the other transactions contemplated by this Agreement. Notwithstanding the foregoing, (i) neither Buyer nor FTH shall be required to divest any of its material assets or accept any material limitation on any of its material businesses other than (x) the divestiture of such broadcast assets (i.e., newspaper and television stations) as it is required to divest or (y) the material limitation on such broadcast assets or Buyer's and FTH's operation thereof as it is required to be subject to, in the case of each of clauses (x) and (y) in order to comply with the FCC Multiple Ownership Rules or a final Order in an action brought by an antitrust or competition or FCC or similar Governmental Authority, (ii) notwithstanding clause (i), neither the Company, Buyer nor FTH shall be required to divest or to hold separate, or to accept any substantial limitation on the operation of, or to waive any rights material to, the Los Angeles or San Francisco television stations of Buyer or the Company (each of the actions described in clause (i) and (ii) above being an "Adverse Condition"), (iii) neither party shall be required to take any of the foregoing actions if such action is not conditioned on the consummation of the Merger and (iv) without limiting Buyer's obligations set forth herein, the Company shall not agree to any of the foregoing without Buyer's consent and, at Buyer's request, the Company shall agree to any of the foregoing so long as such agreement is conditioned upon consummation of the Merger.

(c) Each of Buyer, FTH and the Company shall give (or shall cause its respective subsidiaries to give) any notices to third parties, and Buyer, FTH and the Company shall use, and cause each of its subsidiaries to use, its reasonable best efforts to obtain any third party consents not covered by paragraphs (a) and (b) above, necessary, proper or advisable to consummate the Forward Merger or, if a Restructuring Trigger has occurred, the Reverse Merger; provided that neither Buyer nor FTH shall be required to pay, and the Company shall not pay, without Buyer's prior written consent, any material consideration to obtain any such third party consent. Each of the parties hereto will furnish to the other such necessary information and reasonable assistance as the other may request in connection with the preparation of any required governmental filings or submissions and will cooperate in responding to any inquiry from a Governmental Authority, including immediately informing the other party of such inquiry, consulting in advance before making any presentations or submissions to a Governmental Authority, and supplying each other with copies of all material correspondence, filings or communications between either party and any Governmental Authority with respect to this Agreement.

Section 6.4 Access to Information; Confidentiality.

(a) From the date hereof to the Effective Time, Buyer will comply with the reasonable requests of the Company to make officers available to respond to the reasonable inquiries of the Company in connection with the transactions contemplated by this Agreement and to make available information regarding Buyer and its subsidiaries as the Company may reasonably request.

(b) From the date hereof to the Effective Time, to the extent permitted by applicable Law and contracts, the Company will provide to Buyer (and its officers, directors, employees, accountants, consultants, legal counsel, agents and other representatives, collectively, "Representatives") access to all employees, sites, properties, information and documents which Buyer may reasonably request regarding the business, assets, liabilities, employees and other aspects of the Company; provided, however, that the Company shall not be required to provide access to any employees, sites, properties, information or documents which would breach any agreement with any third-party or which would constitute a waiver of the attorney-client or other privilege by the Company.

(c) Except with respect to matters related to the hiring of employees and the solicitation for hiring of employees, which matters shall be governed by the provisions of Section 6.17 hereof, the parties hereto shall comply with, and shall cause their respective Representatives to comply with all of their respective obligations under the Confidentiality Agreement dated September 16, 1999 between Buyer and the Company, as supplemented by the Addendum to the Confidentiality Agreement, dated August 7, 2000 (as so supplemented, the "Confidentiality Agreement"); provided that, following any termination of this Agreement, Section 6.17 hereof shall be of no further force or effect.

(d) No investigation pursuant to this Section 6.4 shall affect any representation or warranty in this Agreement of any party hereto or any condition to the obligations of the parties hereto.

Section 6.5 No Solicitation of Competing Transactions.

(a) The Company shall not, directly or indirectly, through any officer, director, agent or otherwise, initiate, solicit or knowingly encourage (including by way of furnishing non-public information), or take any other action knowingly to facilitate, any inquiries or the making of any proposal that constitutes, or may reasonably be expected to lead to, any Competing Transaction (as defined below), or enter into or maintain or continue discussions or negotiate with any person or entity in furtherance of such inquiries or to obtain a Competing Transaction, or agree to or endorse any Competing Transaction, or authorize any of the officers, directors or employees of the Company or any investment banker, financial advisor, attorney, accountant or other agent or representative of the Company to take any such action, and the Company shall notify Buyer as promptly as practicable of all of the relevant material details relating to all inquiries and proposals which the Company or any such officer, director, employee, investment banker, financial advisor, attorney, accountant or other agent or representative may receive relating to any of such matters, provided, however, that prior to the adoption of this Agreement and the approval of the Merger by the stockholders of the Company, nothing contained in this Section 6.5 shall prohibit the Board of Directors of the Company from (i) furnishing information to, or entering into and engaging in discussions or negotiations with, any person that makes an unsolicited proposal that the Board of Directors of the Company determines in good faith, after consultation with the Company's financial advisors and independent legal counsel, can be reasonably expected to result in a Superior Proposal; provided that prior to furnishing such information to, or entering into discussions or negotiations with, such person, the Company (1) provides notice to Buyer to the effect that it is furnishing information to, or entering into discussions or negotiations with, such Person and provides, in any such notice to Buyer in reasonable detail the identity of the Person making such proposal and the material terms and conditions of such proposal, and (2) has received from such person or entity an executed confidentiality agreement or (ii) complying with Rule 14e-2 promulgated under the Exchange Act with regard to a tender or exchange offer or making any disclosure required under applicable Law.

(b) For purposes of this Agreement, "Competing Transaction" shall mean any of the following involving the Company: (i) any merger, consolidation, share exchange, business combination, issuance or purchase of securities or other similar transaction other than transactions specifically permitted pursuant to Section 5.1 of this Agreement; (ii) any sale, lease, exchange, mortgage, pledge, transfer or other disposition of the assets of the Company in a single transaction or series of related transactions; (iii) any tender offer or exchange offer for the Company's securities or the filing of a registration statement under the Securities Act in connection with any such exchange offer; in the case of clauses (i), (ii) or (iii) above, which transaction would result in a third party (or its stockholders) acquiring more than 25% of the voting power of the capital stock then outstanding or more than 25% of the assets of the Company and its subsidiaries, taken as a whole; or (iv) any public announcement of an agreement, proposal, plan or intention to do any of the foregoing, either during the effectiveness of this Agreement or at any time thereafter.

For purposes of this Agreement, a "Superior Proposal" means any proposal made by a third party which would result in such party (or in the case of a parent-to-parent merger, its stockholders) acquiring, directly or indirectly, including pursuant to a tender offer, exchange offer, merger, consolidation, share exchange, business combination, share purchase, asset purchase, recapitalization, liquidation, dissolution, joint venture or similar transaction, more than 50% of the voting power of the capital stock then outstanding or all or substantially all of the assets of the Company and its subsidiaries, taken as a whole, for consideration which the Board of Directors of the Company determines in its good faith judgment, after consultation with independent legal counsel and its financial advisors, to be more favorable to the Company's stockholders than the Merger.

Section 6.6 Directors' and Officers' Indemnification and Insurance.

(a) The Certificate of Incorporation and By-Laws of the Surviving Corporation shall contain the provisions with respect to indemnification set forth in the Restated Certificate of Incorporation and By-laws of the Company on the date of this Agreement, which provisions shall not be amended, repealed or otherwise modified after the Effective Time in any manner that would adversely affect the rights thereunder of individuals who at any time prior to the Effective Time were officers, directors or employees of the Company in respect of actions or omissions occurring at or prior to the Effective Time (including, without limitation, the transactions contemplated by this Agreement), unless such modification is required by law.

(b) The Surviving Corporation shall maintain (or cause to be maintained) in effect for six years from the Effective Time directors' and officers' liability insurance covering those persons who are currently covered by the Company's directors' and officers' liability insurance policy on terms comparable to such existing insurance coverage; provided, however, that in no event shall the Surviving Corporation be required to expend pursuant to this Section 6.6 more than an amount per year equal to 300% of current annual premiums paid by the Company for such insurance; and provided further that if the annual premiums exceed such amount, Buyer shall be obligated to obtain a policy with the greatest coverage available for an annual cost not exceeding such amount.

(c) In addition to the other rights provided for in this Section 6.6 and not in limitation thereof (but without in any way limiting or modifying the obligations of any insurance carrier contemplated by Section 6.6(b)), from and after the Effective Time, Buyer shall, and shall cause the Surviving Corporation to, to the fullest extent permitted by applicable Law (the "Indemnifying Party"), (i) indemnify and hold harmless (and release from any liability to Buyer or the Surviving Corporation or any of their respective subsidiaries), the individuals who, on or prior to the Effective Time, were officers, directors or employees of the Company or served on behalf of the Company as an officer, director or employee of any of the Company's current or former subsidiaries or affiliates (including, without limitation, those affiliates listed in Section 6.6(c) of the Company Disclosure Schedule (collectively, "Covered Affiliates") or any of their predecessors in all of their capacities (including as stockholder, controlling or otherwise) and the heirs, executors, trustees, fiduciaries and administrators of such officers, directors or employees (the "Indemnitees") against all Expenses (as defined hereinafter), losses, claims, damages, judgments or amounts paid in settlement ("Costs") in respect of any threatened, pending or completed claim, action, suit or proceeding, whether criminal, civil, administrative or investigative, based on, or arising out of or relating to the fact that such person is or was a director, officer, employee or stockholder (controlling or otherwise) of the Company or any of its current or former subsidiaries or Covered Affiliates or any of their predecessors arising out of acts or omissions occurring on or prior to the Effective Time (including, without limitation, in respect of acts or omissions in connection with this Agreement and the transactions contemplated hereby) (an "Indemnifiable Claim"; except for acts or omissions which involve conduct known to such Person at the time to constitute a material violation of Law); provided that the Surviving Corporation and Buyer shall not be responsible for any amounts paid in settlement of any Indemnifiable Claim without the consent of Buyer and the Surviving Corporation; and (ii) advance to such Indemnitees all Expenses incurred in connection with any Indemnifiable Claim (including in circumstances where the Indemnifying Party has assumed the defense of such claim) promptly after receipt of reasonably detailed statements therefor; provided that the person to whom Expenses are to be advanced provides an undertaking to repay such advances if it is ultimately determined that such person is not entitled to indemnification from Buyer or the Surviving Corporation. Any Indemnifiable Claim shall continue until such Indemnifiable Claim is disposed of or all judgments, orders, decrees or other rulings in connection with such Indemnifiable Claim are fully satisfied. Except as otherwise may be provided pursuant to any Indemnity Agreement, the Indemnitees as a group may retain only one law firm with respect to each related matter except to the extent there is, in the opinion of counsel to an Indemnitee, under applicable standards of professional conduct, a conflict on any significant issue between positions of any two or more Indemnitees; provided that any law firm or firms so retained shall be reasonably acceptable to Buyer. The Indemnifying Party shall be entitled to assume and control the defense of any potential Indemnifiable Claim at its expense and through counsel of its choice if it gives notice of its intention to do so to the Indemnified Party within 30 days of its receipt of notice from the Indemnified Party that a potential Indemnifiable Claim has been made and so long as it unconditionally agrees in writing (x) to indemnify fully and indefinitely, subject only to limitations required by applicable Law, and (y) not to seek repayment of any Expenses advanced (unless such repayment would otherwise be available pursuant to clause (ii) of the first sentence of this Section 6.6(c) solely because such matter was excluded from the definition of Indemnifiable Claim pursuant to the exception contained in the definition thereof appearing immediately prior to the initial proviso in this subsection) from, the Indemnitees in respect of such potential Indemnifiable Claim, and acknowledges in writing its obligation to do so under this Section; provided, however, that, if there exists or is reasonably likely to exist a conflict of interest that would make it inappropriate in the judgment of the Indemnified Party, in its reasonable discretion, for the same counsel to represent both the Indemnified Party and the Indemnifying Party, then the Indemnified Party shall be entitled to retain its own counsel at the expense of the Indemnifying Party. In the event that the Indemnifying Party exercises the right to undertake any such defense against any such Indemnifiable Claim as provided above, the Indemnified Party shall cooperate with the Indemnifying Party in such defense and make available to the Indemnifying Party, at the Indemnifying Party's expense, all witnesses, pertinent records, materials and information in the Indemnified Party's possession or under the Indemnified Party's control relating thereto as is reasonably required by the Indemnifying Party. Similarly, in the event the Indemnified Party is, directly or indirectly, conducting the defense against any such Indemnifiable Claim, the Indemnifying Party shall cooperate with the Indemnified Party in such defense and make available to the Indemnified Party, at the Indemnifying Party's expense, all such witnesses, records, materials and information in the Indemnifying Party's possession or under the Indemnifying Party's control relating thereto as is reasonably required by the Indemnified Party. No such Indemnifiable Claim may be settled by any Indemnified Party without the prior written consent of the Indemnifying Party, which consent will not be unreasonably withheld or delayed. For the purposes of this Section 6.6, "Expenses" shall include reasonable attorneys' fees and all other reasonable costs, charges and expenses paid or incurred in connection with investigating, defending, being a witness in or participating in (including on appeal), or preparing to defend, be a witness in or participate in any Indemnifiable Claim, but shall exclude damages, losses, claims, judgments and amounts paid in settlement. The term "Indemnitees" shall exclude persons who both (x) were serving as officers or directors or employees of the Covered Affiliates listed on Section 6.6(c) of the Company Disclosure Schedule at the request of an entity other than the Company or one of its current or former subsidiaries, or any predecessor thereto, and (y) are not otherwise an Indemnitee.

(d) Notwithstanding anything contained in Section 9.1 hereof to the contrary, this Section 6.6 shall survive the consummation of the Merger indefinitely, is intended to benefit each Indemnitee, shall be binding, jointly and severally, on all successors and assigns of Buyer, the Surviving Corporation and its subsidiaries, and shall be enforceable by the Indemnitees and their successors. In the event that Buyer or the Surviving Corporation or any of its subsidiaries or any of their respective successors or assigns (i) consolidates with or merges into any other Person or (ii) transfers all or substantially all of its properties or assets to any Person, then, and in each case, the successors and assigns of Buyer or the Surviving Corporation or its subsidiary, as the case may be, shall expressly assume and be bound by the indemnification obligations set forth in this Section 6.6.

(e) The obligations of the Surviving Corporation, its subsidiaries and Buyer under this Section 6.6 shall not be terminated or modified in such a manner as to adversely affect any Indemnitee to whom this Section 6.6 applies without the consent of such affected Indemnitee (it being expressly agreed that the Indemnitees to whom this Section 6.6 applies shall be third party beneficiaries of this Section 6.6).

Section 6.7 Notification of Certain Matters. The Company shall give prompt notice to Buyer, and Buyer shall give prompt notice to the Company, of (i) the occurrence, or nonoccurrence, of any event the occurrence, or nonoccurrence, of which would be likely to cause (x) any representation or warranty contained in this Agreement to be untrue or inaccurate or (y) any covenant, condition or agreement contained in this Agreement not to be complied with or satisfied or (z) the Forward Merger not to be consummated and (ii) any failure of the Company or Buyer, as the case may be, to comply with or satisfy any covenant, condition or agreement to be complied with or satisfied by it hereunder; provided, however, that the delivery of any notice pursuant to this Section 6.7 shall not limit or otherwise affect the remedies available hereunder to the party receiving such notice.

Section 6.8 Tax Matters. Buyer and the Company shall make reasonable best efforts to obtain the IRS Ruling, the tax opinions set forth in Sections 7.2(f) and 7.3(c) hereof, and the FCC Consent, including taking any reasonable actions requested by the IRS or the FCC in connection with obtaining the IRS Ruling and the FCC Consent and cooperating in preparing and submitting any filings and documents to the IRS and the FCC in a prompt manner. In the case of the Forward Merger (a) the Agreement is intended to constitute a "plan of reorganization" within the meaning of Section 1.368-2(g) of the income tax regulations promulgated under the Code; (b) neither the Company nor Buyer nor their affiliates shall directly or indirectly (without the consent of the other) take any action, that would reasonably be expected to adversely affect the intended tax treatment of the transactions contemplated by this Agreement; (c) officers of Buyer, Acquisition Sub and the Company shall execute and deliver to Squadron, Ellenoff, Plesent & Sheinfeld LLP, tax counsel to Buyer, and Skadden, Arps, Slate, Meagher & Flom LLP, counsel to the Company, (i) certificates substantially in the form agreed to by the parties as of the date hereof and other appropriate representations at such time or times as may be reasonably requested by such law firms, including contemporaneously with the execution of this Agreement and at the Effective Time, in connection with their respective deliveries of opinions, pursuant to Sections 7.2(f) and 7.3(c) hereof, with respect to the tax treatment of the Merger and (ii) representations required by the U.S. Internal Revenue Service in order to issue the IRS Ruling; and (d) none of the Buyer, Acquisition Sub or the Company shall take or cause to be taken any action which would cause to be untrue (or fail to take or cause not to be taken any action which would cause to be untrue) any of such certificates and representations.

Section 6.9 Stock Exchange Listing. Buyer and the Company shall (a) as promptly as reasonably practicable prepare and submit to the NYSE applications covering the Buyer Shares to be issued in the Merger and the Buyer Shares underlying the Company Options outstanding immediately prior to the Effective Time, and shall use their reasonable best efforts to cause such securities to be approved for listing on the NYSE prior to the Effective Time, (b) within two business days after the Effective Time, prepare and submit to the ASX, pursuant to the applicable listing rules of the ASX, applications covering the Buyer Preferred Stock underlying the Buyer Shares issued pursuant to the Merger and cause such securities to be approved for quotation by the ASX, and (c) promptly seek the ASX Waiver or, if the ASX Waiver is not granted, as soon as possible thereafter call a special meeting of shareholders to obtain the Buyer Shareholder Approval and take all actions and prepare all documents and shareholder materials required in connection therewith.

Section 6.10 Public Announcements. Buyer and the Company shall consult with each other before issuing any press release or otherwise making any public statements with respect to this Agreement and shall not issue any such press release or make any such public statement without the prior consent of the other (which consent shall not be unreasonably withheld or delayed), except as may be required by Law or any listing rules of, or listing agreement or arrangement with, a national securities exchange or the ASX to which Buyer or the Company is a party. The parties have agreed on the text of a joint press release by which Buyer and the Company will announce the execution of this Agreement.

Section 6.11 Affiliates of the Company. The Company represents and warrants to Buyer that prior to the date of the Stockholders' Meeting the Company will deliver to Buyer a letter identifying all persons who may be deemed affiliates of the Company under Rule 145 of the Securities Act, including, without limitation, all directors and executive officers of the Company, and the Company represents and warrants to Buyer that the Company has advised the persons identified in such letter of the resale restrictions imposed by applicable securities laws. The Company shall use its reasonable best efforts to obtain from each person identified in such letter a written agreement, substantially in the form of Exhibit A. The Company shall use its reasonable best efforts to obtain as soon as practicable from any person who may be deemed to have become an affiliate of the Company after the Company's delivery of the letter referred to above and prior to the Effective Time, a written agreement substantially in the form of Exhibit A.

Section 6.12 Employee Matters.

(a) During the one-year period commencing on the Effective Date, Buyer shall provide or shall cause the Surviving Corporation to provide to employees and former employees of the Company and any of its subsidiaries ("Company Employees") employee benefits (including incentive opportunities but excluding benefits under equity-based plans) that are either (i) in the aggregate, substantially comparable to the benefits being provided to Company Employees as of the date of this Agreement under the Company Benefit Plans or (ii) substantially similar to those being provided to similarly situated employees of the Buyer (other than for former employees of the Company).

(b) Without limiting the generality of paragraph (a) of this Section 6.12, if the Effective Time occurs prior to December 31, 2000, (1) each Company Employee who either (a) is a participant in the Company's 2000 Management Incentive Compensation Plan or (b) received an annual bonus in respect of 1999 and is eligible to receive an annual bonus for the year 2000 and who, in either case, is employed by the Company immediately prior to the Effective Time, shall be entitled to receive, in lieu of any other bonus to which the participant may otherwise be entitled under such plan, or for the period from January 1, 2000 through the Effective Time, as the case may be, a prorated bonus (the "Pro-Rata Bonus"), determined by multiplying (i) the participant's annual bonus in respect of 1999 by (ii) a fraction, the numerator of which is equal to the number of days in calendar year 2000 through and including the Effective Time and the denominator of which is 366 and (2) each such Company Employee (other than any person who is a party to an Employment Agreement (as defined in Section 6.12(e) of the Company Disclosure Schedule)) who remains employed with the Company (or its successor) or any affiliate thereof through December 31, 2000, shall be entitled to receive an additional bonus such that, when added to such employee's Pro-Rata Bonus, such employee's aggregate annual bonus in respect of 2000 is not less than such employee's annual bonus in respect of 1999. Such annual bonus with respect of 2000 shall be payable at such time that annual bonuses are normally paid to similarly situated employees of the Company. If the Effective Time occurs during the calendar year 2001, then the process described in (1) of the preceding sentence shall apply in an analogous manner to the Company's 2001 Bonus Plan and to other employees who receive an annual bonus in respect of the year 2000, with the references to the year 2000 therein being deemed to be references to the year 2001 and with references to the year 1999 therein being deemed to be references to the year 2000 and subject to Section 6.12(a), the process for determining the bonus for those who remain employed on and after the Effective Time through December 31, 2001 shall be determined in the discretion of the Buyer.

(c) Without limiting the generality of paragraph (a) of this Section 6.12, with respect to each Buyer Plan, each Surviving Corporation plan and such other employee benefit plans as may be maintained for Company Employees from time to time following the Effective Time by Buyer, the Surviving Corporation or any subsidiary of the Surviving Corporation (including, without limitation, plans or policies providing severance benefits and vacation entitlement), and service with the Company and any of its subsidiaries (or a predecessor to the Company's or any of its subsidiaries' business or assets) shall be treated as service with the Buyer, the Surviving Corporation or any of its subsidiaries, as the case may be, to the extent recognized in the comparable plans of the Company for purposes of determining eligibility to participate and vesting but not for purposes of benefit accrual. Such service also shall apply for purposes of satisfying any waiting periods, evidence of insurability requirements, or the application of any preexisting condition limitations. In the event Company Employees are transferred to a new health plan maintained by the Surviving Corporation effective as of a date within the annual plan year for purposes of accumulating annual deductibles, copayments and out-of-pocket maximums, Company Employees shall be given credit for amounts they have paid under a corresponding benefit plan during the new health plan's year in which the Company Employees are transferred for purposes of applying deductibles, copayments and out-of-pocket maximums as though such amounts had been paid in accordance with the terms and conditions of the benefit plan maintained by Surviving Corporation or any of its subsidiaries. Buyer shall also honor, or cause the Surviving Corporation to honor, all vacation, personal and sick days accrued by the Company Employees under the plans, policies, programs and arrangements of the Company or any of its subsidiaries immediately prior to the Effective Time to the extent reserved against the Company's financial statements.

(d) Without limiting the generality of paragraph (a) of this Section 6.12, Surviving Corporation shall, or shall cause its subsidiaries to, honor, in accordance with their terms, and shall, or shall cause its subsidiaries to, make required payments when due under, all Company Benefit Plans maintained or contributed to by the Company or any of its subsidiaries or to which the Company or any of its subsidiaries is a party (including, but not limited to, employment, incentive and severance agreements and arrangements), that are applicable with respect to any Company Employee or any director of the Company or any of its subsidiaries (whether current, former or retired) or their beneficiaries; provided, however, that, subject to the provisions of Section 6.12(e) of the Company Disclosure Schedule, the foregoing shall not preclude the Surviving Corporation or any of its subsidiaries from amending or terminating any Company Benefit Plan in accordance with its terms.

(e) Buyer and the Surviving Corporation agree to the terms and conditions set forth on Section 6.12(e) of the Company Disclosure Schedule with respect to certain employee benefit matters.

Section 6.13 Letters of the Company's Accountants. The Company shall use reasonable best efforts to cause to be delivered to Buyer two "comfort" letters in customary form from PricewaterhouseCoopers LLP, the Company's independent public accountants, one dated a date within five business days before the date on which the Registration Statement shall become effective and one dated a date within five business days before the Closing Date, each addressed to Buyer.

Section 6.14 Letters of Buyer's Accountants. Buyer shall use reasonable best efforts to cause to be delivered to the Company two "comfort" letters in customary form from Arthur Andersen LLP, Buyer's independent public accountants, one dated a date within five business days before the date on which the Registration Statement shall become effective and one dated a date within five business days before the Closing Date, each addressed to the Company.

Section 6.15 [INTENTIONALLY OMITTED]

Section 6.16 Other Merger Agreements. Buyer shall comply with its obligations under the BHC Merger Agreement and the UTV Merger Agreement. The Company shall comply with its obligations under the voting and proxy agreement related to the BHC Merger and shall cause BHC to comply with its obligations under the voting and proxy agreement related to the UTV Merger.

Section 6.17 Employee Solicitation. In addition to, and not in limitation of any restrictions on the parties hereto contained in other documents, the parties hereto agree that during the period from the date hereof to the earlier of the termination of this Agreement or the consummation of the Merger, neither they nor any of their controlled affiliates shall solicit for employment any current senior management level employees or any of the three (3) highest compensated on air talent employees at each station of the other party hereto. This Section 6.17 shall govern in the event of any inconsistency between this Section 6.17 and Section 6.4 hereof.

Section 6.18 Post-Closing Covenant of Buyer. As of or promptly following the Effective Time, in the case of the Forward Merger Buyer shall cause such assets as Buyer shall determine, but at a minimum shall include the broadcast assets and related liabilities held or previously held by the Company and its subsidiaries, to be transferred to and assumed by one or more direct or indirect subsidiaries of Buyer, and shall cause such assets and liabilities to be ultimately held by, a newly formed subsidiary which is a member of the consolidated group for U.S. federal income tax purposes of News Publishing Australia Limited ("Newco") of Fox Entertainment Group, Inc. ("FEG"). As of or promptly following the Effective Time, Newco and either FTH or a wholly owned subsidiary thereof will enter into the Newco-FTH Agreement (as hereinafter defined). The "Newco-FTH Agreement" shall be an agreement prepared by Buyer and FTH as soon as practicable after the date hereof and in any event no later than August 31, 2000 which (i) reflects and is consistent with the terms set forth on Exhibit B hereto and (ii) otherwise is as Buyer and FTH shall determine, but which is consistent with the objective of obtaining the FCC Consent (without an Adverse Condition) with respect to the Forward Merger and the IRS Ruling; provided that it shall not contain any provisions as to which the Company reasonably objects by reason of concerns as to the Federal income tax treatment of the Forward Merger or the ability to obtain the FCC Consent (without any Adverse Condition) or the IRS Ruling for the Forward Merger. Buyer and FTH shall comply with this Section 6.18 in a manner deemed appropriate by Buyer and FTH; provided, that Buyer and FTH shall act in a manner that preserves (i) the qualification of the Merger as a reorganization under Section 368(a) of the Code and (ii) the effectiveness and validity of the FCC Consent (as defined below). In the event of the Reverse Merger, as of or promptly following the Effective Time, the broadcast assets and related liabilities held by the Company and its subsidiaries (or the Company and its subsidiaries themselves by way of merger) will be transferred to and assumed by FTH or one or more direct or indirect subsidiaries thereof. The foregoing processes contained in this Section 6.18 and the actions contemplated hereby shall be deemed to constitute "transactions contemplated by this Agreement" for purposes of Buyer's representations and warranties herein.

Section 6.19 Form of Merger. In the event that there is a Ruling Failure or an FCC Failure (each, a "Restructuring Trigger"), then the Merger shall be effected as the Reverse Merger and not as the Forward Merger and, in lieu of News Publishing Australia Limited, a newly formed indirect subsidiary of Buyer shall be Acquisition Sub and Buyer shall cause such Acquisition Sub to execute a counterpart signature page to this Agreement and become a party hereto. In the event that following the occurrence of a Restructuring Trigger and prior to the Effective Time, subsequent events occur such that the conditions to effecting the Forward Merger are all satisfied, then the Merger shall occur as if such Triggering Event had never occurred. For purposes of this Agreement, a "Ruling Failure" shall be deemed to have occurred (i) if the IRS Ruling (as defined herein) is not obtained on or prior to the seven month anniversary of the submission of the ruling request to the Internal Revenue Service (unless a responsible officer of the Internal Revenue Service has indicated to representatives of both the Company and Buyer that the IRS Ruling is likely to be issued within the next succeeding three months and such IRS Ruling is so issued within such three month period) in form and substance reasonably satisfactory to each of the parties hereto or (ii) a responsible officer of the Internal Revenue Service has indicated to representatives of both the Company and Buyer prior to the three month anniversary of this Agreement that the IRS Ruling, in form and substance reasonably satisfactory to each of the parties hereto, is not likely to be issued, and such indication shall not have been reversed or withdrawn prior to the five month anniversary of the date of this Agreement or (iii) either Skadden, Arps, Slate, Meagher & Flom LLP or Squadron, Ellenoff, Plesent & Sheinfeld LLP indicates in writing to the Company and Buyer that it will not be able to deliver its respective opinion pursuant to Section 7.3 or Section 7.2, as the case may be. For purposes of this Agreement, an "FCC Failure" shall be deemed to have occurred (i) if the FCC Consent (without an Adverse Condition) is not obtained on or prior to the ten month anniversary of this Agreement (unless a responsible officer of the FCC has indicated to representatives of both the Company and Buyer that the FCC Consent (without an Adverse Condition) will be issued within the next succeeding two months and such FCC Consent is so issued within such two month period) in form and substance reasonably satisfactory to each of the parties hereto or (ii) a responsible officer of the FCC has indicated to representatives of both the Company and Buyer that the FCC Consent, in form and substance reasonably satisfactory to each of the parties hereto, will not be issued and, prior to the three month anniversary of this Agreement, such indication shall not have been reversed or withdrawn; provided that no FCC Failure shall have occurred if a responsible officer of the FCC has indicated (and subsequently not withdrawn or changed such indication) to representatives of both the Company and Buyer that the sole reason or reasons for the FCC Consent (without an Adverse Condition) not having been obtained does not relate in any manner to whether the Merger is the Forward Merger or the Reverse Merger and that there is no material greater likelihood of obtaining the FCC Consent (without an Adverse Condition) with respect to the Reverse Merger than the Forward Merger.

Section 6.20 Obligations of FTH. In view of the fact that one or more subsidiaries of FTH would become the licensees of the Company Stations under either the Forward Merger or the Reverse Merger and would otherwise benefit from either merger, FTH agrees that it shall take such actions, and shall cause its subsidiaries to take such actions, as may be necessary to accomplish the requirements of FTH under Sections 6.3, 6.18 and 6.19 hereof and any other requirements of this Agreement relating to the effectuation of, or transactions to be accomplished immediately following, the Forward Merger or the Reverse Merger, as the case may be.

ARTICLE VII

CONDITIONS TO THE MERGER

Section 7.1 Conditions to the Obligations of Each Party. The obligations of the Company and Buyer to consummate the Merger are subject to the satisfaction or waiver by the Company and Buyer of the following conditions:

(a) this Agreement shall have been adopted by the affirmative vote of a majority of the votes cast by all stockholders entitled to vote at the Stockholders' Meeting (including the holders of the Convertible Preferred Stock) voting together as a single class, and the majority of the holders of the Convertible Preferred Stock, voting as a separate class;

(b) any applicable waiting period under the HSR Act relating to the Merger shall have expired or been terminated;

(c) no Governmental Authority or court of competent jurisdiction shall have enacted, issued, promulgated, enforced or entered any Law, rule, regulation, executive order or Order which is then in effect and has the effect of making the Merger illegal or otherwise prohibiting the consummation of the Merger;

(d) the Registration Statement shall have been declared effective, and no stop order suspending the effectiveness of the Registration Statement shall be in effect and no proceedings for such purpose shall be pending before or threatened by the SEC;

(e) the FCC Consent (as defined below) shall have been obtained. "FCC Consent," as used herein, means action by the FCC granting its consent to the assignment or to the transfer of control of the FCC licenses of the Company and its subsidiaries to FTH (or a wholly owned subsidiary of FTH), including transfer of those authorizations, licenses, permits, and other approvals, issued by the FCC, and used in the operation of the Company Stations, pursuant to appropriate applications filed by the parties with the FCC, as contemplated by this Agreement;

(f) all other authorizations, consents, waivers, orders or approvals for the Merger required to be obtained, and all other filings, notices or declarations required to be made, by Buyer and the Company prior to the consummation of the Merger and the transactions contemplated hereunder, shall have been obtained from, and made with, all required Governmental Authorities, including the ASX Waiver or, if the ASX Waiver is not granted, the Buyer Shareholder Approval, and except for such authorizations, consents, waivers, orders, approvals, filings, notices or declarations the failure to obtain or make which would not, individually or in the aggregate, have a Company Material Adverse Effect or Buyer Material Adverse Effect; provided, however, that a party who has failed to fulfill its obligations under Section 6.3 hereof shall not be entitled to deem this Section 7.1(e) unsatisfied by reason of such non-fulfillment;

(g) the Buyer Shares issuable to the Company's stockholders in the Merger and to holders of Company Options outstanding immediately prior to the Effective Time shall have been authorized for listing on the NYSE, subject to official notice of issuance; and

(h) all conditions to all parties' obligations to consummate the Subsidiary Mergers, except completion of the Merger and, in the case of the UTV Merger, completion of the BHC Merger, shall have been satisfied or waived; provided, however, that this condition may not be enforced by a party whose actions or failure to act has prevented the conditions to the consummation of the Subsidiary Mergers from being satisfied; and provided further that this condition may not be enforced by the Company by reason of the failure to obtain the requisite stockholder vote by the stockholders of BHC or UTV, as the case may be, at a duly held stockholders' meeting called for such purpose or at any adjournment or postponement thereof.

Section 7.2 Conditions to the Obligations of Buyer. The obligations of Buyer to consummate the Merger are subject to the satisfaction or waiver by Buyer of the following further conditions:

(a) each of the representations and warranties of the Company contained in this Agreement that is qualified as to materiality shall be true and correct, and each of the representations and warranties of the Company contained in this Agreement that are not so qualified shall be true and correct in all material respects, in each case as of the date of this Agreement and as of the Effective Time with the same effect as though made as of the Effective Time (except to the extent expressly made as of an earlier date, in which case as of such date), and the Buyer shall have received a certificate signed on behalf of the Company by the chief executive officer or chief financial officer of the Company to such effect;

(b) the Company shall have performed or complied in all material respects with all material agreements and covenants required by this Agreement to be performed or complied with by it on or prior to the Effective Time, and Buyer shall have received a certificate signed on behalf of the Company by the chief executive officer or chief financial officer of the Company to such effect;

(c) Buyer shall have received from each person named in the letter referred to in Section 6.11 an executed copy of an agreement substantially in the form of Exhibit A hereto;

(d) Buyer shall have received evidence, in form and substance reasonably satisfactory to it, that Buyer or the Company shall have obtained (i) all material consents, approvals, authorizations, qualifications and orders of all Governmental Authorities legally required for the consummation of the Merger and (ii) all other consents, approvals, authorizations, qualifications and orders of Governmental Authorities or third parties required (other than those set forth in Section 7.2(d) of the Company Disclosure Schedule) for the consummation of the Merger, except, in the case of this clause (ii), for those the failure of which to be obtained individually or in the aggregate could not reasonably be expected to have a Company Material Adverse Effect or a Buyer Material Adverse Effect; provided, however, that if Buyer has failed to fulfill its obligations under Section 6.3 hereof it shall not be entitled to deem this Section

7.2(d) unsatisfied by reason of such non-fulfillment;

(e) the redemption of the Prior Preferred Stock shall have been consummated in accordance with Section 5.2;

(f) In the case of the Forward Merger, Buyer shall have received (i) the opinion of Squadron, Ellenoff, Plesent & Sheinfeld LLP, in form and substance reasonably satisfactory to Buyer, dated as of the Closing Date, on the basis of facts, representations and assumptions set forth in such opinion, the IRS Ruling, and certificates obtained from officers of Buyer, Acquisition Sub and the Company, all of which are consistent with the state of facts existing as of the Effective Time, to the effect that (A) the Merger will qualify as a reorganization within the meaning of Section 368(a) of the Code, (B) for U.S. federal income tax purposes, no income, gain or loss will be recognized by Buyer, Acquisition Sub and the Company as a result of the Merger, and (C) for U.S. federal income tax purposes, no income, gain or loss will be recognized by the holders of Common Stock Equivalents as a result of the Merger except to the extent such holders receive cash as Merger Consideration and (ii) a private letter ruling (the "IRS Ruling") from the IRS, to the effect that the Merger will satisfy the continuity of business enterprise requirement described in Treasury Regulations Section 1.368-1(d). In rendering the opinion described in clause (i) hereof, Squadron, Ellenoff, Plesent & Sheinfeld LLP shall have received and may rely upon the certificates and representations referred to in Section 6.8 hereof; and

(g) the FCC Consent shall not contain any Adverse Condition.

Section 7.3 Conditions to the Obligations of the Company. The obligations of the Company to consummate the Merger are subject to the satisfaction or waiver by the Company of the following further conditions:

(a) each of the representations and warranties of Buyer contained in this Agreement that is qualified as to materiality shall be true and correct, and each of the representations and warranties of Buyer contained in this Agreement that are not qualified shall be true and correct in all material respects, in each case as of the date of this Agreement and as of the Effective Time with the same effect as though made on and as of the Effective Time (except to the extent expressly made as of an earlier date, in which case as of such date), and the Company shall have received a certificate signed on behalf of Buyer by the chief executive officer or chief financial officer of Buyer to such effect;

(b) Buyer and FTH shall have performed or complied in all material respects with all material agreements and covenants required by this Agreement to be performed or complied with by it on or prior to the Effective Time, and the Company shall have received a certificate signed on behalf of Buyer by the chief executive officer or chief financial officer of Buyer to such effect; and

(c) In the case of the Forward Merger, the Company shall have received (i) the opinion of Skadden, Arps, Slate, Meagher & Flom LLP, in form and substance reasonably satisfactory to the Company, dated as of the Closing Date, on the basis of facts, representations and assumptions set forth in such opinion, the IRS Ruling, and certificates obtained from officers of Buyer, Acquisition Sub and the Company, all of which are consistent with the state of facts existing as of the Effective Time, to the effect that (A) the Merger will qualify as a reorganization within the meaning of Section 368(a) of the Code, (B) for U.S. federal income tax purposes, no income, gain or loss will be recognized by Buyer, Acquisition

Sub and the Company as a result of the Merger, and (C) for U.S. federal income tax purposes, no income, gain or loss will be recognized by the holders of Common Stock Equivalents as a result of the Merger except to the extent such holders receive cash as Merger Consideration and (ii) the IRS Ruling. In rendering the opinion described in clause (i) hereof, Skadden, Arps, Slate, Meagher & Flom LLP shall have received and may rely upon the certificates and representations referred to in Section 6.8 hereof.

ARTICLE VIII

TERMINATION, AMENDMENT AND WAIVER

Section 8.1 Termination. This Agreement may be terminated and the Merger may be abandoned at any time prior to the Effective Time, notwithstanding any requisite adoption of this Agreement and approval of the Merger, as follows:

(a) by mutual written consent duly authorized by the Boards of Directors of each of Buyer and the Company;

(b) by either Buyer or the Company, if the Effective Time shall not have occurred on or before 15 months from the execution of this Agreement (the "Termination Date");

(c) by the Company, upon a breach of any representation, warranty, covenant or agreement on the part of Buyer or FTH set forth in this Agreement, or if any representation or warranty of Buyer shall have become untrue, in either case such that the conditions set forth in Section 7.3(a) or (b) cannot be satisfied on or before the Termination Date (a "Terminating Buyer Breach");

(d) by Buyer, upon breach of any representation, warranty, covenant or agreement on the part of the Company set forth in this Agreement, or if any representation or warranty of the Company shall have become untrue, in either case such that the conditions set forth in Sections 7.2(a) or (b) cannot be satisfied on or before the Termination Date ("Terminating Company Breach");

(e) by either Buyer or the Company, if any Governmental Authority of competent jurisdiction shall have issued an Order or taken any other action permanently restraining, enjoining or otherwise prohibiting the transactions contemplated by this Agreement, and such Order or other action shall have become final and nonappealable;

(f) by Buyer or the Company if the approval of the Merger by the stockholders of the Company required for the consummation of the Merger as set forth in Section 7.1(a) shall not have been obtained by reason of the failure to obtain such required vote at a duly held Stockholders' Meeting or at any adjournment or postponement thereof; or

(g) by Buyer or the Company if either of the Subsidiary Merger Agreements shall have been terminated; provided, however, that a party shall not have the right to terminate this Agreement pursuant to this Section 8.1(g) if its actions or failure to act shall have prevented the consummation of either such Subsidiary Merger; and provided further that this condition may not be enforced by the Company by reason of the failure to obtain the requisite stockholder vote by the stockholders of BHC or UTV, as the case may be, at a duly held stockholders' meeting called for such purpose or at any adjournment or postponement thereof.

Section 8.2 Effect of Termination. Subject to Sections 8.5 and 9.1 hereof, in the event of termination of this Agreement pursuant to Section 8.1, this Agreement shall forthwith become void, there shall be no liability under this Agreement on the part of Buyer, FTH or the Company or any of their respective officers or directors and all rights and obligations of each party hereto shall cease; provided, however, that nothing herein shall relieve any party from liability for the willful breach of any of its representations, warranties, covenants or agreements set forth in this Agreement.

Section 8.3 Amendment. This Agreement may be amended by mutual agreement of the parties hereto by action taken by or on behalf of their respective Boards of Directors at any time prior to the Effective Time; provided, however, that, after the adoption of this Agreement and the approval of the Merger by stockholders of the Company, there shall not be any amendment that by Law requires further approval by the stockholders of the Company without the further approval of such stockholders. This Agreement may not be amended except by an instrument in writing signed by the parties hereto.

Section 8.4 Waiver. At any time prior to the Effective Time, any party hereto may (a) extend the time for the performance of any obligation or other act of any other party hereto, (b) waive any inaccuracy in the representations and warranties contained herein or in any document delivered pursuant hereto and (c) subject to the proviso of Section 8.3, waive compliance with any agreement or condition contained herein. Any such extension or waiver shall only be valid if set forth in an instrument in writing signed by the party or parties to be bound thereby.

Section 8.5 Expenses. Except as set forth in this Section 8.5, all Expenses (as defined below) incurred in connection with this Agreement and the transactions contemplated by this Agreement shall be paid by the party incurring such expenses, whether or not the Merger or any other transaction is consummated, except that the Company and Buyer each shall pay one-half of all Expenses relating to (i) printing, filing and mailing the Registration Statement and the Proxy Statement and all SEC and other regulatory filing fees incurred in connection with the Registration Statement and the Proxy Statement, (ii) any filing with the FCC or similar authority and (iii) any filing with antitrust authorities; provided, however, that Buyer shall pay all Expenses relating to the Exchange Agent and, provided further, that the Company, BHC and UTV shall not, in the aggregate, pay more than one-half of the Expenses. "Expenses" as used in this Agreement (other than Section 6.6 hereof) shall include all reasonable out-of-pocket expenses (including all fees and expenses of counsel, accountants, investment bankers, experts and consultants to a party hereto and its affiliates) incurred by a party or on its behalf in connection with or related to the authorization, preparation, negotiation, execution and performance of this Agreement, the preparation, printing, filing and mailing of the Registration Statement and the Proxy Statement, the solicitation of stockholder and stockholder approvals, the filing of any required notices under the HSR Act or other similar regulations, any filings with the SEC or the FCC and all other matters related to the closing of the Merger and the other transactions contemplated by this Agreement.

ARTICLE IX

GENERAL PROVISIONS

Section 9.1 Non-Survival of Representations, Warranties and Agreements. The representations, warranties and agreements in this Agreement and any certificate delivered pursuant hereto by any person shall terminate at the Effective Time or upon the termination of this Agreement pursuant to Section 8.1, as the case may be, except that this Section 9.1 shall not limit any covenant or agreement of the parties which by its terms contemplates performance after the Effective Time or after termination of this Agreement, including, without limitation, those contained in Sections 6.4, 6.6, 6.8, 6.10, 6.11, 6.12, 6.18 and 6.20.

Section 9.2 Notices. All notices, requests, claims, demands and other communications hereunder shall be in writing and shall be given or made (and shall be deemed to have been duly given or made upon receipt) by delivery in person, by facsimile, by courier service or by registered or certified mail (postage prepaid, return receipt requested) to the respective parties at the following addresses (or at such other address for a party as shall be specified in a notice given in accordance with this Section 9.2):

if to Buyer or to FTH:

The News Corporation Limited
1211 Avenue of the Americas
New York, New York 10036
Telecopier: 212-768-2029
Attention: Arthur M. Siskind, Esq.
Senior Executive Vice President and
Group General Counsel

with copies to:

Squadron, Ellenoff, Plesent & Sheinfeld LLP
551 Fifth Avenue
New York, New York 10176
Telecopier No.: (212) 697-6686
Attention: Jeffrey W. Rubin, Esq.

if to the Company:

Chris-Craft Industries, Inc.
767 Fifth Avenue
New York, New York 10153
Telecopier No.: (212) 759-7653
Attention: General Counsel

with copies to:

Skadden, Arps, Slate, Meagher & Flom LLP
Four Times Square
New York, New York 10036-6522
Telecopier No.: (212) 735-2000
Attention: Lou R. Kling, Esq.
- and -
Howard L. Ellin, Esq.

Section 9.3 Interpretation, Certain Definitions. When a reference is made in this Agreement to an Article, Section or Exhibit, such reference shall be to an Article or Section of, or an Exhibit to, this Agreement, unless otherwise indicated. The table of contents and headings for this Agreement are for reference purposes only and shall not affect in any way the meaning or interpretation of this Agreement. Whenever the words "include," "includes" or "including" are used in this Agreement, they shall be deemed to be followed by the words "without limitation." The words "hereof," "herein" and "hereunder" and words of similar import when used in this Agreement shall refer to this Agreement as a whole and not to any particular provision of this Agreement. All terms defined in this Agreement shall have the defined meanings when used in any certificate or other document made or delivered pursuant hereto unless otherwise defined therein. The definitions contained in this Agreement are applicable to the singular as well as the plural forms of such terms and to the masculine as well as to the feminine and neuter genders of such term. Any statute defined or referred to herein or in any agreement or instrument that is referred to herein means such statute as from time to time amended, modified or supplemented, including (in the case of statutes) by succession of comparable successor statutes. References to a person are also references to its permitted successors and assigns. References to "$" or "dollars" herein shall be deemed to be references to US$.

For purposes of this Agreement, the term:

(a) "affiliate," of a specified Person, means a Person who, directly or indirectly, through one or more intermediaries controls, is controlled by, or is under common control with, such specified Person;

(b) "business day" means any day on which the principal offices of the SEC in Washington, D.C. are open to accept filings, or, in the case of determining a date when any payment is due, any day on which banks are not required or authorized to close in the City of New York;

(c) "control" (including the terms "controlled by" and "under common control with") means the possession, directly or indirectly, or as trustee or executor, of the power to direct or cause the direction of the management and policies of a Person, whether through the ownership of voting securities, as trustee or executor, by contract or credit arrangement or otherwise;

(d) "Governmental Authority" means any United States (Federal, state or local) or foreign government, or governmental, regulatory, judicial or administrative authority, agency or commission;

(e) "knowledge" means the actual knowledge of the following officers and employees of the Company and Buyer, without benefit of an independent investigation of any matter, as to (i) the Company: Herbert J. Siegel, John C. Siegel, William D. Siegel, Brian C. Kelly, Evan C Thompson and Joelen K. Merkel and (ii) Buyer: K.R. Murdoch, D.F. DeVoe, A. Siskind, Peter Chernin and Chase Carey; and

(f) "subsidiary" or "subsidiaries," of any Person, means any corporation, partnership, joint venture or other legal entity of which such Person (either above or through or together with any other subsidiary), owns, directly or indirectly, more than 50% of the stock or other equity interests, the holders of which are generally entitled to vote for the election of the board of directors or other governing body of such corporation or other legal entity. For purposes of this Agreement, FTH and its subsidiaries shall each be deemed to be a subsidiary of Buyer, of FEG and of all of the entities of which FEG is itself a subsidiary.

Section 9.4 Severability. If any term or other provision of this Agreement is invalid, illegal or incapable of being enforced by any rule of Law, or public policy, all other conditions and provisions of this Agreement shall nevertheless remain in full force and effect so long as the economic or legal substance of the Merger is not affected in any manner materially adverse to any party. Upon such determination that any term or other provision is invalid, illegal or incapable of being enforced, the parties hereto shall negotiate in good faith to modify this Agreement so as to effect the original intent of the parties as closely as possible in a mutually acceptable manner in order that the Merger be consummated as originally contemplated to the fullest extent possible.

Section 9.5 Entire Agreement; Assignment. This Agreement (including the Exhibits, the Company Disclosure Schedule and the Buyer Disclosure Schedule which are hereby incorporated herein and made a part hereof for all purposes as if fully set forth herein) and the Confidentiality Agreement constitute the entire agreement among the parties with respect to the subject matter hereof and supersede all prior agreements and undertakings, both written and oral, among the parties, or any of them, with respect to the subject matter hereof. The parties agree to comply with all covenants and agreements set forth on the Company Disclosure Schedule and the Buyer Disclosure Schedule as if such covenants and agreements were fully set forth in this Agreement. This Agreement shall not be assigned by the Company. Buyer shall not assign this Agreement, other than to an affiliate of Buyer; provided that no such assignment shall relieve Buyer of any of its obligations hereunder.

Section 9.6 Parties in Interest. Except as otherwise provided in this Section 9.6, this Agreement shall be binding upon and inure solely to the benefit of each party hereto, and nothing in this Agreement, express or implied, is intended to or shall confer upon any other person any right, benefit or remedy of any nature whatsoever under or by reason of this Agreement other than Sections 6.6 and 6.11 and as specified in paragraph nine (9) of Section 6.12(e) of the Company Disclosure Schedule (which are intended to be for the benefit of the Persons covered thereby and may be enforced by such Persons), 6.20 and, in the event that the Forward Merger is consummated, Sections 6.8 and 6.18 (which three sections are intended for the benefit of the persons who were the stockholders of the Company immediately preceding the Effective Time).

Section 9.7 Governing Law. This Agreement shall be governed by, and construed in accordance with the laws of the State of Delaware.

Section 9.8 Consent to Jurisdiction.

(a) Each of Buyer and the Company hereby irrevocably submits to the exclusive jurisdiction of the courts of the State of Delaware and to the jurisdiction of the United States District Court for the State of Delaware, for the purpose of any action or proceeding arising out of or relating to this Agreement and each of Buyer and the Company hereby irrevocably agrees that all claims in respect to such action or proceeding may be heard and determined exclusively in any Delaware state or federal court. Each of Buyer and the Company agrees that a final judgment in any action or proceeding shall be conclusive and may be enforced in other jurisdictions by suit on the judgment or in any other manner provided by law.

(b) Each of Buyer and the Company irrevocably consents to the service of the summons and complaint and any other process in any other action or proceeding relating to the transactions contemplated by this Agreement, on behalf of itself or its property, by personal delivery of copies of such process to such party in accordance with Section 9.2.

Nothing in this Section 9.8 shall affect the right of any party to serve legal process in any other manner permitted by law.

Section 9.9 Counterparts. This Agreement may be executed and delivered (including by facsimile transmission) in one or more counterparts, and by the different parties hereto in separate counterparts, each of which when executed and delivered shall be deemed to be an original but all of which taken together shall constitute one and the same agreement.

Section 9.10 WAIVER OF JURY TRIAL

EACH OF BUYER AND THE COMPANY HEREBY IRREVOCABLY WAIVES ALL RIGHT TO TRIAL BY JURY IN ANY ACTION, PROCEEDING OR COUNTERCLAIM (WHETHER BASED ON CONTRACT, TORT OR OTHERWISE) ARISING OUT OF OR RELATING TO THIS AGREEMENT OR THE ACTIONS OF BUYER OR THE COMPANY IN THE NEGOTIATION, ADMINISTRATION, PERFORMANCE AND ENFORCEMENT THEREOF.

[REMAINDER OF PAGE INTENTIONALLY LEFT BLANK]

IN WITNESS WHEREOF, Buyer, Acquisition Sub and the Company have caused this Agreement to be executed as of the date first written above by their respective officers thereunto duly authorized.

THE NEWS CORPORATION LIMITED

By: /s/ Arthur M. Siskind

Name: Arthur M. Siskind
Title: Director

NEWS PUBLISHING AUSTRALIA LIMITED

By: /s/ Paula Wardynski

Name: Paula Wardynski
Title: Vice President

FOX TELEVISION HOLDINGS, INC.
(solely as to Section 6.3 and Section 6.20 of this Agreement)

By: /s/ Paula Wardynski

Name: Paula Wardynski
Title: Vice President

CHRIS-CRAFT INDUSTRIES, INC.

By: /s/ Herbert J. Siegel

Name: Herbert J. Siegel
Title: Chairman and President

Delaware

The First State

I, JEFFREY W. BULLOCK, SECRETARY OF STATE OF THE STATE OF DELAWARE, DO HEREBY CERTIFY THE ATTACHED IS A TRUE AND CORRECT COPY OF THE CERTIFICATE OF MERGER, WHICH MERGES:

"CHRIS-CRAFT INDUSTRIES, INC.", A DELAWARE CORPORATION,

WITH AND INTO "NEWS PUBLISHING AUSTRALIA LIMITED" UNDER THE NAME OF "NEWS PUBLISHING AUSTRALIA LIMITED", A CORPORATION ORGANIZED AND EXISTING UNDER THE LAWS OF THE STATE OF DELAWARE, AS RECEIVED AND FILED IN THIS OFFICE THE THIRTY-FIRST DAY OF JULY, A.D. 2001, AT 1 O'CLOCK P.M.

Jeffrey W. Bullock, Secretary of State

2050994 8100M

AUTHENTICATION: 9626700

120715347

DATE: 06-07-12

STATE OF DELAWARE
SECRETARY OF STATE
DIVISION OF CORPORATIONS
FILED 01:00 PM 07/31/2001
010371582 - 2050994

CERTIFICATE OF MERGER

OF

CHRIS-CRAFT INDUSTRIES, INC.

INTO

NEWS PUBLISHING AUSTRALIA LIMITED

(Pursuant to Section 251 of the General Corporation Law of the State of Delaware)

Pursuant to Section 251 of the General Corporation Law of the State of Delaware, News Publishing Australia Limited ("NPAL") certifies the following information relating to the merger (the "Merger") of Chris-Craft Industries, Inc. ("Chris-Craft") with and into NPAL:

FIRST: That the names and states of incorporation of Chris-Craft and NPAL, which are the constituent corporations of the Merger, are as follows:

NAME	STATE OF INCORPORATION
Chris-Craft Industries, Inc.	Delaware
News Publishing Australia Limited	Delaware

SECOND: That an Agreement and Plan of Merger dated as of August 13, 2000 among Chris-Craft, The News Corporation Limited, NPAL and Fox Television Holdings, Inc. (as amended) (the "Plan of Merger") has been approved, adopted, certified, executed and acknowledged by each of the constituent corporations in accordance with the requirements of Section 251 of the General Corporation Law of the State of Delaware.

THIRD: That the name of the surviving corporation of the Merger is News Publishing Australia Limited.

FOURTH: That the Certificate of Incorporation of NPAL shall be the Certificate of Incorporation of the surviving corporation upon the date and time of the filing of this Certificate of Merger with the office of the Secretary of State of the State of Delaware.

FIFTH: That the executed Plan of Merger is on file at an office of the surviving corporation, the address of which is News Publishing Australia Limited, 1211 Avenue of the Americas, New York, NY 10036.

SIXTH: That a copy of the Plan of Merger will be furnished by NPAL, upon the request of and without cost, to any stockholder of NPAL or Chris-Craft.

SEVENTH: That the Merger shall be effective upon the filing of this Certificate of Merger with the Secretary of State of the State of Delaware.

IN WITNESS WHEREOF, this Certificate of Merger has been executed by the undersigned on July 31, 2001.

NEWS PUBLISHING AUSTRALIA LIMITED

By: ____________________
Name: Paula Wardynski
Title: Vice President

Appendix XII-B1

CIVIL CASE INFORMATION STATEMENT
(CIS)

Use for initial Law Division
Civil Part pleadings (not motions) under Rule 4:5-1
Pleading will be rejected for filing, under Rule 1:5-6(c), if information above the black bar is not completed or if attorney's signature is not affixed.

FOR USE BY CLERK'S OFFICE ONLY
PAYMENT TYPE: ☐CK ☐CG ☐CA
CHG/CK NO.
AMOUNT:
OVERPAYMENT:
BATCH NUMBER:

ATTORNEY/PRO SE NAME ROBERT J. DEL TUFO	TELEPHONE NUMBER (212) 735-3000	COUNTY OF VENUE Essex
FIRM NAME (If applicable) SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP		DOCKET NUMBER (When available) ESX-L-9868-05 (PASR)
OFFICE ADDRESS FOUR TIMES SQUARE NEW YORK, NEW YORK 10036		DOCUMENT TYPE ANSWER
		JURY DEMAND ☐ YES ☒ NO

NAME OF PARTY (e.g., John Doe, Plaintiff) NEWS PUBLISHING AUSTRALIA LIMITED THIRD-PARTY DEFENDANT	CAPTION NEW JERSEY DEPARTMENT OF ENVIRONMENTAL PROTECTION, AT AL. V. OCCIDENTAL CHEMICAL CORPORATION, AT AL.
CASE TYPE NUMBER (See reverse side for listing) 156	IS THIS A PROFESSIONAL MALPRACTICE CASE? ☐ YES ☒ NO IF YOU HAVE CHECKED "YES," SEE N.J.S.A. 2A:53A-27 AND APPLICABLE CASE LAW REGARDING YOUR OBLIGATION TO FILE AN AFFIDAVIT OF MERIT.
RELATED CASES PENDING? ☐ YES ☒ NO	IF YES, LIST DOCKET NUMBERS
DO YOU ANTICIPATE ADDING ANY PARTIES (arising out of same transaction or occurrence)? ☐YES ☒ NO	NAME OF DEFENDANT'S PRIMARY INSURANCE COMPANY, IF KNOWN ☐ NONE ☒ UNKNOWN

THE INFORMATION PROVIDED ON THIS FORM CANNOT BE INTRODUCED INTO EVIDENCE.

CASE CHARACTERISTICS FOR PURPOSES OF DETERMINING IF CASE IS APPROPRIATE FOR MEDIATION

DO PARTIES HAVE A CURRENT, PAST OR RECURRENT RELATIONSHIP? ☐YES ☒NO	IF YES, IS THAT RELATIONSHIP	☐ EMPLOYER-EMPLOYEE ☐ FRIEND/NEIGHBOR ☐ OTHER (explain) ☐ FAMILIAL ☐ BUSINESS
DOES THE STATUTE GOVERNING THIS CASE PROVIDE FOR PAYMENT OF FEES BY THE LOSING PARTY?	☐ YES ☒ NO	

USE THIS SPACE TO ALERT THE COURT TO ANY SPECIAL CASE CHARACTERISTICS THAT MAY WARRANT INDIVIDUAL MANAGEMENT OR ACCELERATED DISPOSITION:

DO YOU OR YOUR CLIENT NEED ANY DISABILITY ACCOMMODATIONS?	☐YES ☒ NO	IF YES, PLEASE IDENTIFY THE REQUESTED ACCOMMODATION:
WILL AN INTERPRETER BE NEEDED?	☐YES ☒ NO	IF YES, FOR WHAT LANGUAGE:

I certify that confidential personal identifiers have been redacted from documents now submitted to the court, and will be redacted from all documents submitted in the future in accordance with Rule 1:38-7(b).

ATTORNEY SIGNATURE: [signature]

Revised Effective 9/2009, CN 10517

SIDE 2

CIVIL CASE INFORMATION STATEMENT (CIS)

Use for initial pleadings (not motions) under *Rule* 4:5-1

CASE TYPES (Choose one and enter number of case type in appropriate space on the reverse side.)

Track I — 150 days' discovery

151 NAME CHANGE
175 FORFEITURE
302 TENANCY
399 REAL PROPERTY (other than Tenancy, Contract, Condemnation, Complex Commercial or Construction)
502 BOOK ACCOUNT (debt collection matters only)
505 OTHER INSURANCE CLAIM (INCLUDING DECLARATORY JUDGMENT ACTIONS)
506 PIP COVERAGE
510 UM or UIM CLAIM
511 ACTION ON NEGOTIABLE INSTRUMENT
512 LEMON LAW
801 SUMMARY ACTION
802 OPEN PUBLIC RECORDS ACT (SUMMARY ACTION)
999 OTHER (Briefly describe nature of action)

Track II — 300 days' discovery

305 CONSTRUCTION
509 EMPLOYMENT (other than CEPA or LAD)
599 CONTRACT/COMMERCIAL TRANSACTION
603 AUTO NEGLIGENCE – PERSONAL INJURY
605 PERSONAL INJURY
610 AUTO NEGLIGENCE – PROPERTY DAMAGE
699 TORT – OTHER

Track III — 450 days' discovery

005 CIVIL RIGHTS
301 CONDEMNATION
602 ASSAULT AND BATTERY
604 MEDICAL MALPRACTICE
606 PRODUCT LIABILITY
607 PROFESSIONAL MALPRACTICE
608 TOXIC TORT
609 DEFAMATION
616 WHISTLEBLOWER / CONSCIENTIOUS EMPLOYEE PROTECTION ACT (CEPA) CASES
617 INVERSE CONDEMNATION
618 LAW AGAINST DISCRIMINATION (LAD) CASES
620 FALSE CLAIMS ACT

Track IV — Active Case Management by Individual Judge / 450 days' discovery

156 ENVIRONMENTAL/ENVIRONMENTAL COVERAGE LITIGATION
303 MT. LAUREL
508 COMPLEX COMMERCIAL
513 COMPLEX CONSTRUCTION
514 INSURANCE FRAUD
701 ACTIONS IN LIEU OF PREROGATIVE WRITS

Centrally Managed Litigation (Track IV)

280 Zelnorm
285 Stryker Trident Hip Implants

Mass Tort (Track IV)

248 CIBA GEIGY
266 HORMONE REPLACEMENT THERAPY (HRT)
271 ACCUTANE
272 BEXTRA/CELEBREX
274 RISPERDAL/SEROQUEL/ZYPREXA
275 ORTHO EVRA
277 MAHWAH TOXIC DUMP SITE
278 ZOMETA/AREDIA
279 GADOLINIUM
281 BRISTOL-MYERS SQUIBB ENVIRONMENTAL
282 FOSAMAX
283 DIGITEK
284 NUVARING
286 LEVAQUIN
601 ASBESTOS
619 VIOXX

If you believe this case requires a track other than that provided above, please indicate the reason on Side 1, in the space under "Case Characteristics."

Please check off each applicable category:

☐ Verbal Threshold ☐ Putative Class Action ☐ Title 59

Robert J. Del Tufo
SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP
Four Times Square
New York, New York 10036
Telephone: (212) 735-3000
Facsimile: (212) 735-2000

Peter Simshauser (Admitted Pro Hac Vice)
SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP
One Beacon Street
Boston, Massachusetts 02108
Telephone: (617) 573-4800
Facsimile: (617) 573-4822

Counsel for Third-Party Defendant
News Publishing Australia Limited

NEW JERSEY DEPARTMENT OF ENVIRONMENTAL PROTECTION and THE ADMINISTRATOR OF THE NEW JERSEY SPILL COMPENSATION FUND, Plaintiffs, v. OCCIDENTAL CHEMICAL CORPORATION, TIERRA SOLUTIONS, INC., MAXUS ENERGY CORPORATION, REPSOL YPF, S.A., YPF, S.A., YPF HOLDINGS, INC. and CLH HOLDINGS, INC., Defendants. MAXUS ENERGY CORPORATION and TIERRA SOLUTIONS, INC., Third-Party Plaintiffs, v. 3M COMPANY, *et al.*, Third-Party Defendants.	SUPERIOR COURT OF NEW JERSEY LAW DIVISION: ESSEX COUNTY DOCKET NO. ESX-L-9868-05 (PASR) CIVIL ACTION **ANSWER OF THIRD-PARTY DEFENDANT NEWS PUBLISHING AUSTRALIA LIMITED TO THIRD-PARTY COMPLAINT "B"**

ANSWER OF THIRD-PARTY DEFENDANT
<u>NEWS PUBLISHING AUSTRALIA LIMITED TO THIRD-PARTY COMPLAINT "B"</u>

Third-Party Defendant News Publishing Australia Limited ("NPAL"), by and through its undersigned counsel, and in accordance with this Court's Case Management Order V, Section 9, entered April 16, 2009 ("CMO V"), hereby answers the Third-Party Complaint "B" by Defendants/Third-Party Plaintiffs Maxus Energy Corporation and Tierra Solutions, Inc. ("Third-Party Plaintiffs"), as follows:

<u>GENERALLY</u>

1. NPAL denies each and every allegation contained in Third-Party Complaint "B" that is not otherwise herein addressed, including without limitation any allegations concerning the relief sought in the First Count and the Second Count in Third-Party Complaint "B".

<u>AS TO PROCEDURAL BACKGROUND</u>

(Paragraphs 1 through 15)

2. The referenced pleadings speak for themselves. No response is required pursuant to CMO V.

<u>AS TO THE THIRD-PARTY PLAINTIFFS</u>

(Paragraphs 16 through 18)

3. No response is required pursuant to CMO V.

<u>AS TO THE THIRD-PARTY DEFENDANTS</u>

(Paragraphs 19 through 210)

4. To the extent that the allegations in Paragraphs 19 through 209 relate to parties other than NPAL, no response is required pursuant to CMO V.

5. NPAL admits the allegations in Paragraph 138 that it is a corporation organized under the laws of the State of Delaware with its principal place of business at 1211 Avenue of the Americas, New York, New York.

6. The allegations in Paragraph 210 state a legal conclusion to which no response is required.

AS TO DEFINITIONS

7. Paragraphs 211 through 236 contain definitions. No response is required pursuant to CMO V.

AS TO FACTUAL ALLEGATIONS

(Paragraphs 237 through 3445)

8. To the extent that the allegations in Paragraphs 237 through 3445 relate to other parties, no response is required pursuant to CMO V.

9. The allegations of Paragraph 1906 are descriptive only and no response is required.

10. NPAL admits the allegations of Paragraph 1907 that Montrose Chemical Company ("Montrose") formerly owned and operated a chemical manufacturing facility at 100 Lister Avenue in Newark, New Jersey ("Montrose Site"), from 1946 until 1961. NPAL admits that the following chemicals were manufactured at the Montrose Site at certain times between 1943 and 1972: DDT, benzene hexachloride, lindane, 1,2,4-trichlorobenzene, bis(2-ethylhexyl)phthalate, 2,4-dichlorophenoxyacetic acid ("2,4-D"), and tricresyl phosphate. NPAL denies that Montrose owned and operated the Montrose before 1946 or after 1961, and denies that 2,4,5-trichlorophenoxyacetic acid ("2,4,5-T") was manufactured at the Montrose Site. Except as so admitted or denied, NPAL is without knowledge or information sufficient to form a belief as to the truth of the allegations of Paragraph 1907 and therefore denies them.

11. NPAL admits the allegations of Paragraph 1908 that during certain years before 1950, it manufactured approximately three million pounds of DDT at the Montrose Site. NPAL denies that Montrose manufactured DDT at the Montrose Site after 1950. Except as so

admitted or denied, NPAL is without knowledge or information sufficient to form a belief as to the truth of the allegations of Paragraph 1908 and therefore denies them.

12. NPAL admits the allegations of Paragraph 1909 that Montrose and Baldwin Rubber Company were parties to a merger in 1961, and further admits that the surviving entity was Baldwin-Montrose Chemical Company ("Baldwin-Montrose"). Except as so admitted, NPAL denies the allegations of Paragraph 1909.

13. NPAL admits the allegations of Paragraph 1910 that Baldwin-Montrose merged with Chris-Craft in 1968, and that certain operations continued at the Montrose Site thereafter, until 1972. NPAL further states that Chris-Craft sold the Montrose Site to a third-party in 1972 and had no involvement with, or responsibility for, operations at the site thereafter. Except as so admitted and stated, NPAL denies the allegations of Paragraph 1910.

14. NPAL admits the allegations of Paragraph 1911 that in August 2000, an agreement and plan of merger were entered into by and among Chris-Craft, The News Corporation Limited, NPAL, and Fox Television Holdings, Inc. NPAL further admits that pursuant to the merger, which was concluded in 2001 following regulatory approvals, Chris-Craft was merged into NPAL. Except as so admitted, NPAL denies any factual allegations of Paragraph 1911. The last sentence of Paragraph 1911 states a legal conclusion to which no response is required.

15. NPAL is without knowledge or information sufficient to form a belief as to the truth of the allegations of Paragraphs 1912-1913, and therefore denies them.

16. NPAL denies the allegation of Paragraph 1914 that the Montrose Site is proximate to the Passaic River. NPAL is without knowledge or information sufficient to form

a belief as to the truth of the remaining allegations of Paragraph 1914, and therefore denies them.

17. NPAL admits the allegation of Paragraph 1915 that floor drains and troughs in production areas and buildings at the Montrose Site collected process wastewaters and conveyed the effluent into a sanitary sewer line beneath Lister Avenue. NPAL denies the allegation of Paragraph that News America, Inc. generated process wastewaters at the Montrose Site. NPAL is without knowledge or information sufficient to form a belief as to the truth of the remaining allegations of Paragraph 1915, and therefore denies them.

18. NPAL is without knowledge or information sufficient to form a belief as to the truth of the allegations of Paragraphs 1916-1918, and therefore denies them.

19. NPAL denies the allegation of Paragraph 1919 that wastewater from the Montrose Site was discharged directly to the Passaic River. NPAL is without knowledge or information sufficient to form a belief as to the truth of the remaining allegations of Paragraph 1919, and therefore denies them.

20. NPAL is without knowledge or information sufficient to form a belief as to the truth of the allegations of Paragraphs 1920-1926, and therefore denies them.

21. Paragraphs 1927 and 1928 purport to characterize letters from EPA to Chris-Craft; the letters speak for themselves and no response is required.

22. Paragraph 1929 states legal conclusions to which no response is required. To the extent a response is required, NPAL denies that it is liable in any amount or at all, to any person or entity, either public or private, for any contamination in the Passaic River or the Newark Bay Complex.

AS TO FIRST COUNT

New Jersey Spill Compensation and Control Act, N.J.S.A. 58:10-23.11.f.a.2(a)

23. NPAL incorporates by reference as if fully set forth herein its responses and denials as asserted in Paragraphs 1 through 22 herein.

24. Paragraphs 3447-3451 state legal conclusions to which no response is required. To the extent that a response is required, NPAL denies that it is liable to Third-Party Plaintiffs in any amount or at all.

AS TO SECOND COUNT

Statutory Contribution

25. NPAL incorporates by reference as if fully set forth herein its responses and denials as asserted in Paragraphs 1 through 24 herein.

26. Paragraph 3453 states legal conclusions to which no response is required. To the extent that a response is required, NPAL denies that it is liable to Third-Party Plaintiffs in any amount or at all.

FIRST AFFIRMATIVE DEFENSE

27. The Third-Party Complaint is barred in whole or in part as it fails to state a cause of action against NPAL upon which relief can be granted.

SECOND AFFIRMATIVE DEFENSE

28. NPAL is not a discharger or a person in any way responsible for a discharge under N.J.S.A. 58:10-23 *et seq.* ("Spill Act").

THIRD AFFIRMATIVE DEFENSE

29. The claims of Third-Party Plaintiffs are barred in whole or in part by the statutory defenses to liability provided by the Spill Act and the Water Pollution Control Act, N.J.S.A. 58:10A-1 *et seq.* ("WPCA").

FOURTH AFFIRMATIVE DEFENSE

30. Third-Party Plaintiffs have no Spill Act claim against NPAL because they have not cleaned up and/or removed a discharge of hazardous substances within the meaning of the Spill Act.

FIFTH AFFIRMATIVE DEFENSE

31. Third-Party Plaintiffs have no right of contribution against NPAL under the WPCA.

SIXTH AFFIRMATIVE DEFENSE

32. Third-Party Plaintiffs' claims are barred, in whole or in part, by the entire controversy doctrine.

SEVENTH AFFIRMATIVE DEFENSE

33. To the extent the Third-Party Complaint purports to seek any relief under New Jersey's Environmental Rights Act, N.J.S.A. 2A:35A-1 et seq., in whole or in part, the pleading is barred because Third-Party Plaintiffs have failed to meet the procedural and/or substantive requirements entitling them to sue NPAL under that statute.

EIGHTH AFFIRMATIVE DEFENSE

34. Some or all of Third-Party Plaintiffs do not have standing to sue.

NINTH AFFIRMATIVE DEFENSE

35. Upon information and belief, Third-Party Plaintiffs are mere corporate shells who are periodically infused with cash or equivalent contributions by other corporate entities which money Third-Party Plaintiffs purport to use to address the environmental contamination at issue in this litigation. Consequently, the claims by Third-Party Plaintiffs are barred under the collateral source doctrine or its equitable equivalent.

TENTH AFFIRMATIVE DEFENSE

36. Third-Party Plaintiffs are not the real parties in interest for pursuit of the claims set forth in the Third-Party Complaint, nor are Third-Party Plaintiffs acting in the capacity of an executor, administrator, guardian of a person or property, trustee of an express trust, or a party with whom or in whose name a contract has been made for the benefit of another. Consequently, all claims are barred under R. 4:26-1 of the New Jersey Court Rules.

ELEVENTH AFFIRMATIVE DEFENSE

37. Third-Party Plaintiffs are mere volunteers for remediation of the environmental contamination for which they claim contribution and/or other relief from NPAL. Consequently, the claims in the Third-Party Complaint are barred, in whole or in part.

TWELFTH AFFIRMATIVE DEFENSE

38. The claims brought by Third-Party Plaintiffs reflect damages that are wholly speculative, conjectural, unreasonable, excessive and/or arbitrary and capricious.

THIRTEENTH AFFIRMATIVE DEFENSE

39. NPAL cannot be held liable for or be required to pay Third-Party Plaintiffs' damages or other claims based on actions or inactions by NPAL that arise out of conduct lawfully undertaken in compliance with permits or other approvals issued by relevant government agencies, including the State of New Jersey and/or the United States and/or in compliance with applicable laws, regulations, rules, orders, ordinances, directives and common law, and other requirements of all foreign, federal, state and local government entities ("applicable Environmental Laws").

FOURTEENTH THIRD AFFIRMATIVE DEFENSE

40. At common law, NPAL held, and still holds, a usufructuary interest allowing it, along with all other citizens, the reasonable use of assets held for the benefit of the public by

the State of New Jersey under the Public Trust Doctrine. NPAL has at all relevant times acted in accordance with its rights of reasonable use of publicly held assets. As a matter of law, Third-Party Plaintiffs' claims are derivative of, and cannot be any greater than, the claims that the State of New Jersey has or would have against NPAL directly. As a result, the claims set forth in the Third-Party Complaint are barred, in whole or in part.

FIFTEENTH AFFIRMATIVE DEFENSE

41. The State of New Jersey is legally barred from asserting direct claims against NPAL for the damages sought in its Amended Complaint. Consequently, all claims that are or may be derivative of the State of New Jersey's claims are barred as to the NPAL as well, including the claims set forth in the Third-Party Complaint.

SIXTEENTH AFFIRMATIVE DEFENSE

42. The Third-Party Complaint is barred and/or is constitutionally impermissible to the extent that it seeks to impose retroactive liability for acts that were previously authorized or condoned by law including applicable Environmental Laws.

SEVENTEENTH AFFIRMATIVE DEFENSE

43. Third-Party Plaintiffs' Complaint is barred to the extent that it seeks relief for damages incurred prior to the effective date of the Spill Act.

EIGHTEENTH AFFIRMATIVE DEFENSE

44. At all relevant times, NPAL complied with all applicable Environmental Laws, regulations, industry standards and ordinances, and otherwise conducted itself reasonably, prudently, in good faith, and with due care for the rights, safety and property of others.

NINETEENTH AFFIRMATIVE DEFENSE

45. The claims asserted against NPAL in the Third-Party Complaint are barred because at all relevant times NPAL exercised due care with respect to hazardous substances, if

any, that may have been handled at the subject property or properties, took precautions against foreseeable acts or omissions of others and the consequences that could reasonably result from such acts or omissions, and because any release or threat of release of any hazardous substances, if any, and any costs or damages resulting therefrom, were caused solely by the negligence, acts or omissions of third parties over whom NPAL had no control, whether by, in whole or part, contract or otherwise, or any duty to control, including without limitation the State of New Jersey and its agencies and officials, and the United States and its agencies and officials.

TWENTIETH AFFIRMATIVE DEFENSE

46. The claims set forth in the Third-Party Complaint are barred in whole or in part by the doctrine of preemption.

TWENTY-FIRST AFFIRMATIVE DEFENSE

47. Third-Party Plaintiffs suffered no losses or injuries that were proximately caused by NPAL.

TWENTY-SECOND AFFIRMATIVE DEFENSE

48. Third-Party Plaintiffs' claims against NPAL are barred, in whole or in part, by the applicable Statute of Limitations, Statute of Repose, and/or the equitable doctrines of laches and estoppel.

TWENTY-THIRD AFFIRMATIVE DEFENSE

49. Third-Party Plaintiffs' claims are barred in whole or in part by the doctrines of accord and satisfaction, waiver, consent, estoppel, release and/or assumption of risk.

TWENTY-FOURTH THIRD AFFIRMATIVE DEFENSE

50. Third-Party Plaintiffs' claims are barred, in whole or in part, by the doctrine of "coming to the nuisance."

TWENTY-FIFTH AFFIRMATIVE DEFENSE

51. Third-Party Plaintiffs' claims are barred, in whole or in part, by the "unclean hands" doctrine.

TWENTY-SIXTH AFFIRMATIVE DEFENSE

52. The claims for equitable contribution under the Spill Act in the Third-Party Complaint are barred because: (1) equity will not compel action that is impossible of performance; (2) equity will not exceed the rights of parties existing at law; (3) equity will not consciously become an instrument of injustice; and/or (4) equity will not permit double satisfaction.

TWENTY-SEVENTH AFFIRMATIVE DEFENSE

53. Third-Party Plaintiffs' claims are barred, in whole or in part, by the doctrines of collateral estoppel, *res judicata*, and/or judicial estoppel including in connection with prior findings as to Third-Party Plaintiffs' intentional misconduct.

TWENTY-EIGHTH AFFIRMATIVE DEFENSE

54. Third-Party Plaintiffs' claims are barred because the relief sought against NPAL, were it claimed directly by Plaintiffs, would amount to unlawful taxation.

TWENTY-NINTH AFFIRMATIVE DEFENSE

55. Third-Party Plaintiffs' claims against NPAL are subject to setoff and recoupment and therefore must be reduced accordingly.

THIRTIETH AFFIRMATIVE DEFENSE

56. NPAL did not own or operate a "Major Facility" as defined by the Spill Act or the WPCA.

THIRTY-FIRST AFFIRMATIVE DEFENSE

57. Third-Party Plaintiffs' claims are barred, in whole or in part, by Third-Party Plaintiffs' failure to comply with the prerequisites to liability under the Spill Act including, without limitation to, Third-Party Plaintiffs' have not incurred costs authorized by the Spill Act and Third-Party Plaintiffs' have failed to direct cleanup and removal activities in accordance with the National Contingency Plan to the greatest extent possible.

THIRTY-SECOND AFFIRMATIVE DEFENSE

58. Third-Party Plaintiffs' claims are barred because neither they nor Plaintiffs have incurred "costs of restoration and replacement ... of any natural resources damaged or destroyed by a discharge" under the Spill Act.

THIRTY-THIRD AFFIRMATIVE DEFENSE

59. Third-Party Plaintiffs have failed to join necessary and indispensable parties needed for a just adjudication of the claims asserted in this action, in whose absence complete relief can not be afforded the existing parties pursuant to R. 4:28-1 of the New Jersey Court Rules. These necessary and indispensable parties include, without limitation, State of New Jersey agencies and instrumentalities, including without limitation the State trustees for tidelands, certain United States agencies and instrumentalities with liability under the Spill Act, and certain state and local governmental agencies located outside the boundaries of New Jersey, including the State of New York and its agencies and instrumentalities, all of whom are or may be separately liable for contamination allegedly located in the "Newark Bay Complex," as defined in Plaintiffs' Second Amended Complaint.

THIRTY-FOURTH THIRD AFFIRMATIVE DEFENSE

60. Third-Party Plaintiffs' claims are not ripe for adjudication, inter alia, because Third-Party Plaintiffs have a joint liability to the Plaintiffs and have not paid and will not pay more than their fair or equitable share of the liability.

THIRTY-FIFTH AFFIRMATIVE DEFENSE

61. NPAL denies that Third-Party Plaintiffs have suffered any harm whatsoever, but in the event that they did suffer any form of injury or damage cognizable under applicable Environmental Law, such injury was caused by the intervening acts, omissions, or superseding acts of persons or entities over whom NPAL exercised no control and for whose conduct NPAL was not responsible including, without limitation, unpermitted and storm event discharges from publically owned treatment works.

THIRTY-SIXTH AFFIRMATIVE DEFENSE

62. If Third-Party Plaintiffs sustained any injury or are entitled to any damages, such injury and damages were wholly, or in part, caused by Third-Party Plaintiffs' own acts or omissions, negligence, lack of due care and fault and/or that of Third-Party Plaintiffs' agents or employees. In the event that Third-Party Plaintiffs are found to have sustained any injury and are entitled to damages, Third-Party Plaintiffs' recovery against NPAL, if any, must be reduced by the proportionate damages caused by the acts and conduct of Third-Party Plaintiffs and/or its agents or employees.

THIRTY-SEVENTH AFFIRMATIVE DEFENSE

63. Although NPAL denies that it is liable for the contamination described in Third-Party Plaintiffs' Complaint, in the event it is found liable, NPAL is entitled to an offset against any such liability on its part for the equitable share of the liability of any person or entity not joined as a defendant in this action that would be liable to Third-Party Plaintiffs.

THIRTY-EIGHTH AFFIRMATIVE DEFENSE

64. Under N.J.S.A. 2A:15-97, the amount of damages, if any, should be reduced by any amounts recovered from any other source.

THIRTY-NINTH AFFIRMATIVE DEFENSE

65. Third-Party Plaintiffs' claims are barred to the extent that the conduct of NPAL alleged to give rise to liability in the Third-Party Complaint is the subject of a release, covenant not to sue, or has otherwise been excused by Plaintiffs, including, without limitation, through issuance of a no further action letter, consent order, settlement agreement or other applicable document, with or without inclusion of contribution protection, or through the Plaintiffs' allowance of any applicable Statute of Limitations or Statute of Repose to lapse.

FORTIETH AFFIRMATIVE DEFENSE

66. The disposal of waste, if any, which allegedly originated from NPAL, was undertaken in accordance with the then state of the art, the then accepted industrial practice and technology, and the then prevailing legal requirements for which NPAL cannot be found retroactively liable.

FORTY-FIRST AFFIRMATIVE DEFENSE

67. Any discharge that allegedly originated from NPAL, was investigated and remediated by a licensed professional and under the direct oversight of state and/or federal agencies with the then state of the art, the then accepted industrial practice and technology, and the then prevailing requirements for which NPAL cannot be found retroactively liable.

FORTY-SECOND AFFIRMATIVE DEFENSE

68. Third-Party Plaintiffs are not entitled to recover costs incurred for cleanup actions not undertaken in coordination or conjunction with federal agencies.

FORTY-THIRD AFFIRMATIVE DEFENSE

69. The damages or other relief that Third-Party Plaintiffs seek, if awarded, would result in unjust enrichment to the Third-Party Plaintiffs.

FORTY-FOURTH THIRD AFFIRMATIVE DEFENSE

70. Third-Party Plaintiffs' claims are barred due to its own conduct in unilaterally, and without notice to NPAL, implementing clean-up plan(s) or taking other actions that resulted in the commingling of formerly divisible areas of environmental harm.

FORTY-FIFTH AFFIRMATIVE DEFENSE

71. NPAL's liability to Third-Party Plaintiffs, if any, is limited to Spill Act and contribution claims and excludes any such claims which may properly be apportioned to parties pursuant to *Burlington Northern and Santa Fe Railway Co., et al. v. United States, et al.*, 556 U.S. ____; 129 S.Ct. 1870 (2009), and other comparable decisional law.

FORTY-SIXTH AFFIRMATIVE DEFENSE

72. Third-Party Plaintiffs cannot assert contribution claims against NPAL because the discharges for which the Plaintiffs are seeking relief are different from NPAL's alleged discharges.

FORTY-SEVENTH AFFIRMATIVE DEFENSE

73. Third-Party Plaintiffs cannot seek contribution under the Joint Tortfeasors Contribution Law because NPAL is not liable for "the same injury" caused by Third-Party Plaintiffs' discharges and do not share a common liability to the State of New Jersey.

FORTY-EIGHTH AFFIRMATIVE DEFENSE

74. Third-Party Plaintiffs' claims are barred to the extent they seek to hold NPAL liable, in contribution, for any claims for which it would be a violation of public policy to hold NPAL liable, including but not limited to punitive damages and penalties.

FORTY-NINTH AFFIRMATIVE DEFENSE

75. Third-Party Plaintiffs' claims are barred, in whole or in part, because no actions or inactions by NPAL have resulted in any permanent impairment or damage to a natural resource.

FIFTIETH AFFIRMATIVE DEFENSE

76. Third-Party Plaintiffs claims for contribution, whether under the Spill Act or the New Jersey statutory provisions for contribution, are derivative of, and are therefore no greater than, Plaintiffs' claims against Third-Party Plaintiffs. Consequently, Third-Party Plaintiffs' claims against NPAL are barred to the extent of any legal extinguishments of actual or potential claims by the Plaintiffs against NPAL pertaining to the alleged environmental contamination (including natural resource damage) of any site(s) alleged by Third-Party Plaintiffs to be the subject of their contribution claims against NPAL. Examples of legal extinguishments that are or may be applicable to NPAL include, with respect to each such site:

A. Any release or covenant not to sue granted by Plaintiffs to NPAL;

B. Any settlement or other compromise between Plaintiffs and NPAL;

C. Any expiration of the statute of limitations or statute of repose governing Plaintiffs' right to maintain a claim against NPAL;

D. Any failure to join a claim relating to the "Newark Bay Complex" (as defined in the Third-Party Complaint) in a prior litigation between Plaintiffs and NPAL, which would result in relinquishment of such a claim by virtue of New Jersey's Entire Controversy Doctrine; and/or

E. Any issuance by Plaintiffs to NPAL, directly or indirectly, of any "No Further Action" (a/k/a "NFA") determination, "Negative Declaration," or similar determination.

FIFTY FIRST AFFIRMATIVE DEFENSE

77. Third-Party Plaintiffs' claims are barred because the relief sought against NPAL, were it claimed directly by Plaintiffs, would amount to a "taking" of NPAL's property in

violation of its constitutional rights to due process and/or in violation of its rights under the Eminent Domain Act of 1971, N.J.S.A. 20:3-1 *et seq.*

FIFTY SECOND AFFIRMATIVE DEFENSE

78. Third-Party Plaintiffs' claims are barred to the extent the relief sought by Third-Party Plaintiffs in the Complaint is at odds with NPAL's responsibilities to conduct ongoing environmental cleanups under oversight of the Plaintiffs at any site(s) alleged by Third-Party Plaintiffs to be the subject of their contribution claims against NPAL, thereby exposing NPAL to inconsistent responsibilities, penalties and liabilities, and the possibility of paying twice for the same actions (i.e., double recovery).

FIFTY THIRD AFFIRMATIVE DEFENSE

79. To the extent NPAL is acting or has acted to conduct environmental cleanup at any site(s) alleged by Third-Party Plaintiffs to be the subject of their contribution claims against NPAL, the claims for equitable contribution under the Spill Act in the Third-Party Complaint are barred because equity will not compel action that is already being undertaken and/or is unnecessary.

FIFTY FOURTH AFFIRMATIVE DEFENSE

80. Without admitting liability, NPAL alleges that if it is found to have been engaged in any of the activities alleged in the Third-Party Complaint, such activities were *de minimis* and not the cause of any damages or other claims by Third-Party Plaintiffs.

FIFTY FIFTH AFFIRMATIVE DEFENSE

81. NPAL incorporates by reference any affirmative defense asserted by other parties in this action to the extent such affirmation defenses are defenses to Third-Party Plaintiffs' claims and do not impose liability on NPAL.

FIFTY SIXTH AFFIRMATIVE DEFENSE

82. NPAL reserves the right to assert and hereby invoke each and every Environmental Law defenses that may be available during the course of this action.

COUNTER-CLAIMS, CROSS CLAIMS AND THIRD/FOURTH PARTY CLAIMS

83. No such claims are required to be asserted at this time and are expressly reserved pursuant to CMO V.

DESIGNATION OF TRIAL COUNSEL

84. In accordance with Rule 4:25-4 you are hereby notified that Robert J. Del Tufo is assigned to try this case.

CERTIFICATION PURSUANT TO RULE 4:5-1(B)(2)

85. Pursuant to Rule 4:5-1(b)(2), the undersigned hereby certifies that:

a) The matter in controversy is not the subject of any other action pending in any court or of a pending arbitration proceeding and no action or arbitration proceeding is contemplated by the undersigned; and

b) Since it is the legal position of the undersigned that the potential liability, if any, of a third party defendant for the claims set forth in the Third-Party Complaint is several, only, there are no non-parties, which should be joined in the action pursuant to Rule 4:28; but that

c) In the event the Court shall determine that the potential liability of a third party defendant, if any, for the claims set forth in the Third Party Complaint is in any respect joint and several (which is denied), then all or some of the non-parties listed on the October, 2009 posting by O'Melveny and Myers may constitute non-parties who should be joined in the action pursuant to Rule 4:28; and

d) In either event, some or all of such non-parties are subject to joinder pursuant to Rule 4:29-1(b) because of potential liability to any party on the basis of the same transactional facts.

WHEREFORE, NPAL respectfully requests that the Court enter an Order dismissing the Third-Party Complaint "B" with prejudice, and awarding costs, attorneys' fees and any other relief the Court deems just and proper.

Dated: November 9, 2009

Respectfully submitted,

Robert J. Del Tufo
SKADDEN, ARPS, SLATE,
MEAGHER & FLOM LLP
Four Times Square
New York, New York 10036
Telephone: (212) 735-3000

Counsel for Third-Party Defendant
News Publishing Australia Limited

Corporations Section
P.O.Box 13697
Austin, Texas 78711-3697

Secretary of State

Office of the Secretary of State

CERTIFICATE OF AMENDMENT
OF

Novelis Corporation
800204347

[formerly: Alcan Aluminum Corporation]

The undersigned, as Secretary of State of Texas, hereby certifies that the attached Articles of amendment for the above named entity have been received in this office and have been found to conform to law.

ACCORDINGLY the undersigned, as Secretary of State, and by virtue of the authority vested in the Secretary by law hereby issues this Certificate of Amendment.

Dated: 12/22/2004
Effective: 01/01/2005

Geoffrey S. Connor
Secretary of State

FILED
In the Office of the
Secretary of State of Texas
DEC 22 2004
Corporations Section

ARTICLES OF AMENDMENT
TO THE
ARTICLES OF INCORPORATION
OF
ALCAN ALUMINUM CORPORATION

Pursuant to the provisions of Article 4.04 of the Texas Business Corporation Act, Alcan Aluminum Corporation, a Texas corporation (the "Corporation"), hereby adopts these Articles of Amendment (this "Amendment") to its Articles of Incorporation:

ARTICLE 1

Article One of the Articles of Incorporation of the Corporation is hereby amended so as to read in its entirety as follows:

"ARTICLE ONE

The name of the corporation (the "Corporation") is Novelis Corporation."

ARTICLE 2

This Amendment was duly adopted by the sole shareholder of the Corporation on the 17th day of December, 2004 to be effective January 1, 2005.

ARTICLE 3

Of the 10,000 shares of common stock of the Corporation issued and outstanding, 10,000 such shares voted for and no shares voted against this Amendment.

ARTICLE 4

This Amendment shall be effective January 1, 2005.

IN WITNESS WHEREOF, the undersigned has executed this Amendment as of this 22nd day of December, 2004.

ALCAN ALUMINUM CORPORATION

By: Charles R. Aley
Charles R. Aley
Secretary

Connell Foley LLP
85 Livingston Avenue
Roseland, New Jersey 07068
(973) 535-0500
Attorneys for Harrison Supply Company

NEW JERSEY DEPARTMENT OF ENVIRONMENTAL PROTECTION and THE ADMINISTRATOR OF THE NEW JERSEY SPILL COMPENSATION FUND, Plaintiffs, v. OCCIDENTAL CHEMICAL CORPORATION, TIERRA SOLUTIONS, INC., MAXUS ENERGY CORPORATION, REPSOL YPF, S.A., YPF, S.A., YPF HOLDINGS, INC. and CLH HOLDINGS, INC., Defendants, And MAXUS ENERGY CORPORATION and TIERRA SOLUTIONS, INC. Third-Party Plaintiffs, v. 3M COMPANY, et al. Third-Party Defendants.	SUPERIOR COURT OF NEW JERSEY LAW DIVISION: ESSEX COUNTY DOCKET NO.: L-9868-05 (PASR) CIVIL ACTION **CERTIFICATION OF KENNETH E. PHILLIPS**

I, KENNETH E. PHILLIPS, upon my oath depose and say:

1. I am president of Third-Party Defendant, Harrison Supply Company ("Harrison Supply") and also served as Philbro, Inc. ("Philbro") prior to its consolidation into the Phillips Companies, Inc. on or about December 31, 2009.

2. The allegations against Harrison Supply and Philbro are set forth in paragraphs 1437 to 1444 of the Third Party Complaint B.

3. Harrison Supply has been named in the Third Party Complaint as a lessee/operator of the "Harrison Supply Site" since 1927.

4. Philbro is named in the Complaint as the owner of the "Harrison Supply site."

5. Since 1927, the Harrison Supply site has been owned by Philbro and Harrison Supply has been a lessee/operator.

6. Philbro did not conduct operations on the Harrison Supply site and is merely an owner and lessor. Additionally, Philbro and Harrison Supply have some common ownership.

I hereby certify that the foregoing statements made by me are true. I hereby certify that if any of the foregoing statements made by me are willfully false, I am subject to punishment.

BY:______________________________
KENNETH E. PHILLIPS

DATED: 4/18/2013

2895844-01

Glenn A. Harris, Esquire
BALLARD SPAHR LLP
A Pennsylvania Limited Liability Partnership
210 Lake Drive East, Suite 200
Cherry Hill, New Jersey 08002
Phone: 856.761.3400
Fax: 856.761.1020

Attorneys for Third-Party Defendants E. I. du Pont de Nemours and Company and Pitt-Consol Chemical Company

NEW JERSEY DEPARTMENT OF ENVIRONMENTAL PROTECTION and THE ADMINISTRATOR OF THE NEW JERSEY SPILL COMPENSATION FUND, Plaintiffs, v. OCCIDENTAL CHEMICAL CORPORATION, TIERRA SOLUTIONS, INC., MAXUS ENERGY CORPORATION, REPSOL YPF, S.A., YPF, S.A., YPF HOLDINGS, INC. and CLH HOLDINGS, INC., Defendants. MAXUS ENERGY CORPORATION and TIERRA SOLUTIONS, INC., Third-Party Plaintiffs, vs. 3M COMPANY, *et al.*, Third-Party Defendants.	SUPERIOR COURT OF NEW JERSEY LAW DIVISION: ESSEX COUNTY DOCKET NO. L-9868-05 CIVIL ACTION **CERTIFICATION OF BERNARD J. REILLY**

Bernard J. Reilly, being of full age, makes the following certified statements:

1. I am Corporate Counsel for E. I. du Pont de Nemours and Company ("DuPont"). I am the corporate counsel in charge of this litigation for both DuPont and for Pitt-Consol Chemical Company ("Pitt-Consol").

2. I have personal knowledge of the facts set forth herein.

3. At all times relevant hereto, Pitt-Consol has been a wholly-owned subsidiary of Du Pont Chemical and Energy Operations, Inc. ("DCEO"), a Delaware corporation.

4. At all times relevant hereto, DCEO has been a wholly-owned subsidiary of DuPont.

5. Thus, Pitt-Consol is a Private Settling Third-Party Defendant that is an Affiliated Entity with respect to DuPont.

I certify that the foregoing statements made by me are true. I am aware that if any of the foregoing statements made by me are wilfully false, I am subject to punishment.

By: Bernard J Reilly
Bernard J. Reilly

DATED: March 5, 2013

SEC Filings

10-K

PPG INDUSTRIES INC filed this Form 10-K on 02/21/2013

Entire Document

Exhibit 21

PPG Industries, Inc.
And Consolidated Subsidiaries

Subsidiaries of the Registrant
December 31, 2012

Significant subsidiaries included in the 2012 consolidated financial statements of the Company are:

	Percentage of Voting Power
United States:	
Pinetree Stockholding Corporation - Delaware	100
PPG Architectural Finishes, Inc. - Delaware	100
PPG Capital LLC - Delaware	100
PPG Industries Fiber Glass Products, Inc. - Delaware	100
PPG Industries International, Inc. - Delaware	100
PPG Industries Ohio, Inc. - Delaware	100
PPG Industries Securities, Inc. - Delaware	100
PPG Kansai Automotive Finishes U.S., LLC - Delaware	60
PRC-DeSoto International, Inc. - California	100
Sierracin Corporation - Delaware	100
Sierracin/Sylmar Corporation - California	100
The CEI Group, Inc. - Pennsylvania	75
Transitions Optical, Inc. - Delaware	51
Other Americas:	
American Finishes Inversiones S.A. - Chile	100
PPG ALESCO Automotive Finishes Mexico, S. de R.L. de C.V. - Mexico	60
PPG Canada Inc. - Canada	100
PPG Industrial do Brasil - Tintas E. Vernizes - Ltda. - Brazil	100
PPG Industries Argentina S.R.L. - Argentina	100
PPG Industries Chile S.A. - Chile	100
PPG Industries Colombia Ltda. - Colombia	100
PPG Industries de Mexico, S.A. de C.V. - Mexico	100
PPG Kansai Automotive Finishes Canada, LP - Canada	60
Transitions Optical do Brasil Limitada - Brazil	51

	Varossieau Suriname NV - Suriname	51.01
EMEA:		
	Brown Brothers Distribution Limited - United Kingdom	100
	Compagnie Equatoriale des Peintures - Cameroon	51.44
	Dyrup A/S - Denmark	100
	Dyrup SAS - France	100
	Dyrup SP. Z O.O. - Poland	100
	EPIC Insurance Co. Ltd. - British Virgin Islands.	100
	Gabonaise de Peintures et Laques - Gabon	51.01
	Intercast Europe S.r.l. - Italy	100
	Johnstone's Paints Limited - United Kingdom	100
	Kalon Investment Company Limited- United Kingdom	100
	Kalon South Africa Proprietary Limited - South Africa	100
	La Seigneurie Caraibes - Guadeloupe	100

La Seigneurie Ocean Indien - La Reunion	51
Peinture de Paris SAS - France	99.95
PPG (Austria) Handels GmbH - Austria	100
PPG AC - France SA - France	99.95
PPG Architectural Coatings UK Limited - United Kingdom	100
PPG Auto Refinish AG - Switzerland	100
PPG Coatings B.V. - The Netherlands	100
PPG Coatings Belux N.V. - Belgium	100
PPG Coatings BVBA/SPRL - Belgium	100
PPG Coatings Danmark AS - Denmark	100
PPG Coatings Deutschland GmbH - Germany	100
PPG Coatings Europe B.V. - The Netherlands	100
PPG Coatings Nederland BV - The Netherlands	100
PPG Coatings S.A. - France	99.9
PPG Coatings South Africa (Pty) Ltd. - South Africa.	100
PPG Deco Czech a.s. - Czech Republic	100
PPG Deco Polska sp. z.o.o. - Poland	100
PPG Deco Slovakia, s.r.o. - Slovakia	100
PPG Deutschland Business Suport GmbH - Germany	100
PPG Deutschland Sales & Services GmbH - Germany	100
PPG Distribution S.A.S. - France	99.95
PPG Dr. Schoch AG - Switzerland	100
PPG Europe B.V. - The Netherlands	100
PPG Finance B.V. - The Netherlands	100
PPG France Business Support S.A.S. - France	100
PPG France Manufacturing S.A.S. - France	100
PPG Holdco SAS - France	100
PPG Holdings (U.K.) Limited - United Kingdom	100
PPG Ibérica, S.A. - Spain	100
PPG Ibérica Sales & Services, S.L. - Spain.	100
PPG Industrial Coatings B.V. - The Netherlands	100
PPG Industries (UK) Ltd - United Kingdom	100
PPG Industries Belgium B.V.B.A. - Belgium	100
PPG Industries Chemicals B.V. - The Netherlands	100
PPG Industries Europe Sàrl - Switzerland	100
PPG Industries Fiber Glass B.V. - The Netherlands	100
PPG Industries France S.A.S. - France	100
PPG Industries Italia S.p.A. - Italy	100
PPG Industries Kimya a Sanayi VE Ticaret AS - Turkey	100
PPG Industries Lackfabrik GmbH - Germany	100
PPG Industries Netherlands B.V. - The Netherlands	100
PPG Industries Poland Sp. Z.o.o. - Poland	100
PPG Italia Business Support S.r.l - Italy	100

PPG Italia Sales & Service S.r.l. - Italy.	100
PPG Luxembourg Finance S.àR.L. - Luxembourg	100
PPG Luxembourg Holdings S.àR.L. - Luxembourg	100
PPG Polifarb Cieszyn S.A. - Poland	100
PPG Retail Europe - France	99.95
PPG Service Sud S.r.l. - Italy	100
PPG-Helios Limited (d.o.o.) - Slovenia	60
Prominent Paints Proprietary Limited - South Africa	100
Sigma Marine & Protective Coatings Holding B.V. - The Netherlands	100
SigmaKalon (BC) UK Limited - United Kingdom	100
SigmaKalon UK Holding Limited - United Kingdom	100
Societe des Anciens Etablissements Peppler - France	99.95
Tintas DYRUP, S.A. - Portugal	100
Transitions Optical Holdings B.V. - The Netherlands	51
Transitions Optical Limited - Ireland	51
Trilak Festékgyartó Korlatolt Felelösségü Tarsasag - Hungary	100

Asia:

Foshan Bairun Chemicals Co., Ltd. - China.	100
PPG Aerospace Materials (Suzhou) Co. Ltd. - China	100
PPG Asian Paints Private Ltd. - India	50
PPG Coatings (Hong Kong) Co., Limited - Hong Kong	100
PPG Coatings (Kunshan) Co., Ltd. - China	100
PPG Coatings (Malaysia) Sdn. Bhd. - Malaysia	100
PPG Coatings (Shanghai) Co., Ltd. - China	100
PPG COATINGS (SINGAPORE) PTE. LTD - Singapore	100
PPG Coatings (Suzhou) Company Ltd. - China	100
PPG Coatings (Thailand) Co., Ltd. - Thailand	100
PPG Coatings (Tianjin) Co., Ltd. - China	100
PPG Coatings (Wuhu) Company, Ltd. - China	100
PPG Coatings (Zhangjiagang) Co., Ltd. - China	100
PPG Industries (Korea) Ltd. - South Korea	100
PPG Industries (Singapore) Pte., Ltd. - Singapore	100
PPG Industries Australia PTY Limited - Australia	100
PPG Industries New Zealand Limited - New Zealand	100
PPG Japan Ltd.- Japan	100
PPG Packaging Coatings (Suzhou) Co., Ltd. - China	100
PPG Paints Trading (Shanghai) Co., Ltd. - China	100
PPG PERFORMANCE COATINGS (HONG KONG) LIMITED - Hong Kong	100
PPG Performance Coatings (Malaysia) Sdn. Bhd. - Malaysia	100
PPG PMC Japan Co., Ltd. - Japan	95
PPG SSC Co., Ltd. - South Korea	60
PRC-Desoto Australia Pty Ltd. - Australia	100

Protec Pty Ltd. A.C.N. 007 857 392 - Australia	100
PT. PPG Coatings Indonesia - Indonesia	100
Sikar (Shanghai) Trading Co. Ltd. - China	100
Solarlens Co., Ltd. - Thailand	100
Taiwan Chlorine Industries Ltd. - Taiwan	60
Transitions Optical (S) Pte. Ltd - Singapore	51
Transitions Optical (Thailand) Ltd. - Thailand	51
Transitions Optical Philippines, Inc. - Philippines	51
Transitions Optical PTY Ltd. A.C.N. 067 278 139 - Australia	51

PPG INDUSTRIES, INC.
ASSISTANT SECRETARY'S CERTIFICATE

I, RITA BERGSTROM, do hereby certify that:

(1) I am the Assistant Secretary of PPG Industries, Inc., a Pennsylvania corporation (the "Company"), and custodian of its minute books, corporate records, and seal; and hereby further certify that:

(2) On July 30, 1999, PRC-DeSoto International, Inc., a California corporation, became a wholly owned and consolidated subsidiary of PPG Industries, Inc. ("PPG"), as shown in Exhibit 21 of PPG's 10-K filed annually with the Securities and Exchange Commission;

(3) Attached hereto is a true and correct copy of the Restated Articles of Incorporation and all Amendments for PRC-DeSoto International, Inc.

IN WITNESS WHEREOF, I have hereunto signed my name and affixed the seal of the Company as of the 20th day of February, 2013.

Rita Bergstrom

Rita Bergstrom
Assistant Secretary

State of California
Secretary of State

I, BRUCE McPHERSON, Secretary of State of the State of California, hereby certify:

That the attached transcript of 34 page(s) was prepared by and in this office from the record on file, of which it purports to be a copy, and that it is full, true and correct.

IN WITNESS WHEREOF, I execute this certificate and affix the Great Seal of the State of California this day of

DEC 21 2006

BRUCE McPHERSON
Secretary of State

Sec/State Form CE 108 (REV 03/31/05)

OSP 05 94202

(12) 719097

A79270

FILED
In the office of the Secretary of State of the State of California
SEP 11 1968
FRANK M. JORDAN, Secretary of State
By [signature] Deputy

RESTATED

ARTICLES OF INCORPORATION

of

PRODUCTS RESEARCH & CHEMICAL CORPORATION

(As Amended through September 11, 1968)

The undersigned, George Gregory and Lloyd L. Cooper, hereby certify that they are, respectively, the duly elected and acting President and Secretary of Products Research & Chemical Corporation, a California corporation, and that the following correctly sets forth the text of the Articles of Incorporation of said corporation, as amended to the date of this certificate:

FIRST: That the name of this corporation is PRODUCTS RESEARCH & CHEMICAL CORPORATION.

SECOND: That this corporation will primarily engage in the manufacture, sale and distribution of sealants.

That the purposes for which this corporation is formed are the following:

a) To carry on business in the United States or elsewhere; to buy, sell and deal in all kinds of merchandise, including chromate compound gasketing, and to carry on any other business including the manufacture, processing and sale thereof.

b) To manufacture, buy, sell and generally deal in machinery of all kinds and such mechanical devices and engineering appliances as are generally manufactured and dealt in by gasket manufacturers, chromate processing plants and allied businesses.

c) To purchase, hold and lease, either as lessor or lessee; to sell or mortgage, maintain, operate and generally deal in any and all lands, improved and unimproved, and buildings of any kind and any and all other property of any and every kind or description, real, personal and mixed, wheresoever situated, including water and water rights.

d) To buy, lease and in any and all other ways acquire, hold and own, and to sell, lease or otherwise dispose of patents, licenses and processes or rights thereunder of every character which this corporation may deem advantageous in the prosecution of its business.

e) To borrow money, to issue bonds, notes, debentures or other obligations of this corporation from time to time, for any of the objects or purposes of this corporation, and to secure the same by mortgage, pledge, deed of trust or otherwise, or to issue the same unsecured.

f) To lend money; to purchase or sell, mortgage or otherwise dispose of and deal in shares, bonds, notes, debentures of any other person, corporation or association to the same extent as a natural person could or might do.

g) To carry on any business whatsoever which this corporation may deem proper or convenient; to act as agent, broker or attorney in fact for any other person, corporation or association; to conduct a general insurance agency and insurance brokerage business under proper license to be issued therefor.

h) To own, lease or otherwise acquire, and to manage, operate and control theatres and other places of amusement, and to operate a motion picture business, film recording and television business.

i) To buy, contract for, lease and in any and all other ways deal in mining claims, mineral rights, oil wells, gas lands, and other real property and rights and interests in and to real property, and to manage, improve and develop said properties, including refineries and manufacturing plants, for the production, distribution and sale of oil and gas.

j) To carry on the business of farming, selling and dealing in all farm products.

k) To do each and everything necessary, suitable or proper for the accomplishment of any of the purposes or the attainment of any one or more of the objects herein enumerated, or which shall at any time appear conducive to or expedient to the prosecution and benefit of this corporation.

l) In general to carry on any other lawful business whatsoever in connection with the foregoing, or which may be calculated, directly or indirectly, to promote the interests of the corporation or to enhance the value of its properties. To do each and all things above set forth to the same extent as fully as natural persons might do or could do in the State of California or in any other state, country or place.

THIRD: That the principal office for the transaction of the business of this corporation is to be located in the County of Los Angeles, State of California.

✓ FOURTH: The total number of shares of all classes which the Corporation shall have authority to issue is six million (6,000,000) shares to consist of five million (5,000,000) shares of Common Stock, par value \$2 per share, and one million (1,000,000) shares of Preferred Stock, par value \$5 per share. The aggregate par value of all shares that are to have a par value shall be fifteen million dollars (\$15,000,000).

The preferences, limitations and relative rights of each class of shares shall be:

1. Preferred Stock. The Preferred Stock may be issued from time to time in one or more series. The Board of Directors is hereby authorized to fix or alter any of the following: the dividend rights, dividend rate, conversion rights, voting rights, rights and terms of redemption (including sinking fund provisions), the redemption price or

prices, and the liquidation preferences of any wholly unissued series of Preferred Stock, the number of shares constituting any such series and the designation thereof; and the Board of Directors is hereby authorized to increase or decrease the number of shares of any series subsequent to the issue of shares of that series, but not below the number of shares of such series then outstanding. In case the number of shares of any series shall be so decreased, the shares constituting such decrease shall resume the status which they had prior to the adoption of the resolution originally fixing the number of shares of such series.

2. Common Stock. The holders of Common Stock issued and outstanding shall have and possess the exclusive voting rights and powers, and the holders of Preferred Stock shall not be entitled to vote upon the election of directors or upon any questions affecting the management or affairs of this Corporation, except where such vote is required by law, or where such voting rights may be granted to such holders of Preferred Stock by the Board of Directors pursuant to the provisions of the preceding paragraph. The holders of the Common Stock also shall have and possess all dividend and liquidation rights except to the extent that such rights may be granted to holders of the Preferred Stock

4. That the foregoing amendment of the Articles of Incorporation has been duly approved by the required vote of shareholders in accordance with Section 902 of the Corporations Code. The total number of outstanding shares of the corporation is 4,544,343. The number of shares voting in favor of the amendment equaled or exceeded the vote required. The percentage vote required was more than 50%.

DEAN M. WILLARD, President and
Chief Operating Officer

JEFF YOUNG, Secretary

Each of the undersigned declares under penalty of perjury that the matters set forth in the foregoing certificate are true and correct. Executed at Glendale, California, on February 16, 1983.

DEAN M. WILLARD

JEFF YOUNG

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FILED
In the office of the Secretary of State
of the State of California

NOV 10 1987

March Fong Eu
MARCH FONG EU, Secretary of State

CERTIFICATE OF OWNERSHIP

DEAN M. WILLARD and WILLAM CALFAS certify that:

1. They are the duly elected and acting president and secretary of Products Research & Chemical Corporation, a California corporation (this "Corporation").

2. This Corporation owns at least 90% of the outstanding shares of each class of Text Sciences Corporation, a California corporation ("Subsidiary").

3. The board of directors of this Corporation has duly adopted the following resolutions:

RESOLVED, THAT: this Corporation merge Text Sciences Corporation, its subsidiary, into itself and assume all its obligations pursuant to Section 1110 of the California Corporations Code.

RESOLVED FURTHER, THAT: upon the effectiveness of said merger each issued and outstanding share of said subsidiary not owned by this corporation shall cease to be outstanding and each holder of such shares shall be entitled to receive the sum of $1.67 cash in exchange for such shares upon surrender of certificates evidencing the same.

4. The board of directors of Subsidiary has adopted the following resolution:

WHEREAS, it is proposed that this Corporation be merged into Products Research and Chemical Corporation, a California corporation, and this board of directors has reviewed the consideration to be issued to its shareholders other than Products Research and Chemical Corporation, for each share of this Corporation held by such shareholders.

THEREFORE, BE IT HEREBY RESOLVED, THAT: this board of directors hereby approves of the fairness of such consideration to be received for each share of this Corporation not owned by said Products Research and Chemical Corporation, such consideration to consist of $1.67 cash for each such share.

We further declare, under penalty of perjury under the laws of the State of California that the matters set forth in this certificate are true and correct of our own knowledge.

Executed at Glendale, California this 2nd day of November, 1987.

Dean M. Willard, President

William Calfas, Secretary

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FILED 8
In the office of the Secretary of State
of the State of California

APR 28 1989

March Fong Eu
MARCH FONG EU, Secretary of State

CERTIFICATE OF AMENDMENT

OF

ARTICLES OF INCORPORATION

DEAN M. WILLARD and WILLIAM CALFAS certify that:

1. They are the President and Secretary, respectively, of PRODUCTS RESEARCH & CHEMICAL CORPORATION, a California corporation.

2. The Articles of Incorporation of this corporation are hereby amended to add new Articles SIXTH and SEVENTH which shall read as follows:

"SIXTH: The Liability of the directors of the corporation for monetary damages shall be eliminated to the fullest extent permissible under California Law.

SEVENTH: The corporation is authorized to provide indemnification of agents (as defined in Section 317 of the Califor[illegible] Corporations Code) through bylaw provisions, agreements with agents, vote of shareholders of disinterested directors or otherwise, in excess of the indemnification otherwise permitted by Section 317 of the California Corporation Code."

3. The foregoing amendment of Articles of Incorporation has been duly approved by the Board of Directors of this corporation.

4. The foregoing amendment of Articles of Incorporation has been duly approved by the required vote of Shareholders in accordance with Section 902 of the Corporation Code. The total number of outstanding shares of the corporation is 7,489,314. The number of shares voting in favor of the amendment equaled or exceeded the vote required. The percentage vote required was more than 50%.

We further declare under penalty of perjury under the laws of the State of California that the matters set forth in this certificate are true and correct of our own knowledge.

Date: March 1, 1989

DEAN M. WILLARD, President

WILLIAM CALFAS, Secretary

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FILED
In the office of the Secretary of State
of the State of California

OCT - 2 1989

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March Fong Eu
MARCH FONG EU, Secretary of State

AGREEMENT OF MERGER

THIS AGREEMENT OF MERGER (the "Agreement"), dated as of October 2, 1989, between Products Research & Chemical Corporation (hereinafter referred to as "Surviving Corporation") and Courtaulds Acquisition Corp. (hereinafter referred to as "Disappearing Corporation");

WITNESSETH:

WHEREAS, Surviving Corporation is a California corporation authorized to issue 1,000,000 preferred shares, par value $5.00 per share, and 20,000,000 common shares, par value $2.00 per share, of which there are outstanding at the date hereof no preferred shares and 8,303,714 common shares;

WHEREAS, Disappearing Corporation is a California corporation authorized to issue 1,000 common shares, no par value, of which there are outstanding at the date hereof 100 shares; and

WHEREAS, Surviving Corporation and Disappearing Corporation have entered into an Agreement and Plan of Merger dated as of July 7, 1989 (the "Merger Agreement"), providing for certain representations, warranties and agreements in connection with the transactions contemplated therein and herein.

NOW, THEREFORE, Surviving Corporation and Disappearing Corporation agree to merge on the following terms and conditions (the "Merger"):

1. Merger. At the Effective Time of the Merger (as defined in Section 6 herein): the separate existence of Disappearing Corporation shall cease and Disappearing Corporation shall be merged with and into Surviving Corporation and the corporate existence of Surviving Corporation shall continue. The corporate identity, existence, name, purposes, franchises, powers, rights and immunities of Surviving Corporation shall continue unaffected and unimpaired by the Merger; and the corporate identity, existence, purposes, franchises, powers, rights and immunities of Disappearing Corporation shall be merged into Surviving Corporation which shall be fully vested therewith. Surviving Corporation shall be subject to all of the debts and liabilities of Disappearing Corporation as if Surviving Corporation had itself incurred them and all rights of

creditors and all liens upon the property of each of Surviving Corporation and Disappearing Corporation shall be preserved unimpaired, provided that such liens, if any, upon the property of Disappearing Corporation shall be limited to the property affected thereby immediately prior to the Effective Time of the Merger.

2. Articles of Incorporation and By-laws. The Articles of Incorporation of Surviving Corporation, as in effect immediately prior to the Effective Time of the Merger, shall be amended so that Article Fourth of such Articles of Incorporation reads in its entirety as follows: "The total number of shares of all classes of stock which the corporation shall have authority to issue is 1,000 shares of common stock, par value $2.00 per share." and, as so amended, such Articles of Incorporation shall be the Articles of Incorporation of Surviving Corporation, and the By-laws of Disappearing Corporation, as in effect immediately prior to the Effective Time of the Merger, shall be the By-laws of Surviving Corporation.

3. Directors and Officers. The directors of Surviving Corporation from and after the Effective Time of the Merger (until changed in accordance with applicable law and the Articles of Incorporation and By-laws of Surviving Corporation) shall be George Gregory, Dean M. Willard, William Calfas, Richard D. Lapthorne, Sipko Huismans, Irvin P. Seegman and David J. Giachardi. The officers of Surviving Corporation from and after the Effective Time of the Merger (until changed in accordance with applicable law and the Articles of Incorporation and By-laws of Surviving Corporation) shall be the officers of Surviving Corporation holding such positions immediately prior to the Effective Time of the Merger.

4. Effect of the Merger on Outstanding Shares.

As of the Effective Time of the Merger, by virtue of the Merger and without any action on the part of the holder of any shares of capital stock:

(a) Disappearing Corporation. Each issued and outstanding share of the capital stock of Disappearing Corporation shall be converted into and become one fully paid and nonassessable share of Common Stock, par value $2.00 per share, of Surviving Corporation.

(b) Cancelation of Parent-Owned Stock. All shares of Common Stock of Surviving Corporation that are owned directly or indirectly by Surviving Corporation, by any subsidiary of Surviving Corporation or by Courtaulds plc, a company incorporated under the laws of England and the indirect parent of Disappearing Corporation ("Parent"), Disappearing Corporation or any other subsidiary of Parent, shall be canceled, and no consideration shall be delivered in exchange therefor.

(c) Conversion of Common Stock of Surviving Corporation. Subject to Section 4(d) below, each issued and outstanding share of Common Stock of Surviving Corporation (other than shares to be canceled pursuant to Section 4(b) above) shall be converted into the right to receive in cash, without interest, $32 per share. All such shares of Common Stock of Surviving Corporation, other than shares held by dissenting shareholders, shall no longer be outstanding and shall automatically be canceled and retired and shall cease to exist, and each holder of a certificate representing any such shares shall cease to have any rights with respect thereto, except the right to receive in cash, without interest, $32 per share in consideration therefor upon the surrender of such certificate to the bank or trust company selected by Parent to act as paying agent (the "Paying Agent").

(d) Dissenting Shares. Notwithstanding anything in this Agreement to the contrary, shares of Common Stock of the Surviving Corporation with respect to which a proper demand has been made in accordance with Section 1301 of the General Corporation Law of the State of California (the "GCL") and which are "dissenting shares" (as defined in Section 1300(b) of the GCL) held by a dissenting shareholder shall not be converted as described above in Section 4(c), but shall become the right to receive such consideration as may be determined to be due to such dissenting shareholder pursuant of the GCL; provided, however, if a dissenting shareholder who demands that the Company purchase his dissenting shares of Common Stock of the Surviving Corporation at their fair market value under the GCL shall have withdrawn or lost his right to require the Company to do so under the GCL, then, as of the Effective Time of the Merger or, if later, the occurrence of such event, such dissenting shareholder's shares or rights shall be deemed to be converted into the right to receive in cash, without interest thereon, the price per share of Common Stock of the Surviving Corporation specified in Section 4(c).

5. Surrender of Share Certificates. As soon as practicable after the Effective Time of the Merger, the

Paying Agent shall mail to each holder of record of a certificate or certificates that immediately prior to the Effective Time of the Merger represented outstanding shares of Common Stock of Surviving Corporation, other than Surviving Corporation, Parent and any subsidiary of Surviving Corporation or Parent, (i) a letter of transmittal and (ii) instructions for use in effecting the surrender of certificates in exchange for $32 cash per share. Upon surrender of a certificate for cancelation, together with such letter of transmittal, duly executed, the holder of such certificate shall be entitled to receive in exchange therefor the amount of cash into which the shares theretofore represented shall have been converted and such certificate shall forthwith be canceled. No interest shall be paid or shall accrue on the cash payable upon the surrender of any certificate.

6. Effective Time of the Merger. Subject to the provisions of the Merger Agreement, upon compliance with applicable laws and upon receipt of any required approval of the outstanding shares of either party, a copy of this Agreement of Merger with an officer's certificate of each of Surviving Corporation and Disappearing Corporation as required by Section 1103 of the GCL shall be filed in the office of the Secretary of State of the State of California, together with a certificate of satisfaction of the Franchise Tax Board, as soon as practicable on or after the Closing Date (as defined in Section 2.2 of the Merger Agreement). The Merger shall become effective (the "Effective Time of the Merger") upon the filing with the Secretary of State of the State of California of this Agreement of Merger, together with other required documents.

7. Other Provisions.

(a) Governing Law. This Agreement of Merger shall be governed by the laws of California.

(b) Entire Agreement. This Agreement and the Merger Agreement between the parties hereto contain the entire agreement of the parties hereto, and supersede any prior written or oral agreements between them concerning the subject matter contained herein.

(c) Counterparts. This Agreement of Merger may be executed in any number of counterparts and each such counterpart shall be deemed to be an original instrument, but all of such counterparts together shall constitute but one agreement.

(d) Further Assurances. Disappearing Corporation shall from time to time upon request by Surviving Corporation execute and deliver all such documents and instruments and take all such action as Surviving Corporation may request in order to vest or evidence the vesting in Surviving Corporation of title to and possession of all rights, properties, assets and business of Disappearing Corporation, or otherwise to carry out the full intent and purpose of this Agreement of Merger.

IN WITNESS WHEREOF, Disappearing Corporation and Surviving Corporation have caused this Agreement of Merger to be executed as of the day and year first above written.

PRODUCTS RESEARCH & CHEMICAL CORPORATION

By ______________________
Dean M. Willard
President and Chief Executive Officer

By ______________________
William Calfas
Executive Vice President and Secretary

COURTAULDS ACQUISITION CORP.

By ______________________
Derek F. Twogood
President

By Stephen A. Briley
Stephen A. Briley
Secretary

[2200-034III/E05/5A/4205]

CERTIFICATE OF APPROVAL
OF
PRODUCTS RESEARCH & CHEMICAL CORPORATION
OF
THE AGREEMENT OF MERGER

Jeffrey Young and William Calfas, certify that:

1. They are the duly elected and acting Vice President of Finance, Treasurer and Chief Financial Officer, and Executive Vice President and Secretary, respectively, of Products Research & Chemical Corporation, a California corporation (hereinafter called "this Corporation").

2. This certificate is attached to the Agreement of Merger dated as of October 2, 1989, providing for the merger of Courtaulds Acquisition Corp., a California corporation, with and into this Corporation.

3. The Agreement of Merger in the form attached hereto has been approved by the Board of Directors of this Corporation.

4. The principal terms of the Agreement of Merger in the form attached hereto were approved by this Corporation by the vote of a number of shares of the only outstanding class of stock of this Corporation which equaled or exceeded the vote required, such class, the total number of outstanding shares of such class entitled to vote on the merger and the percentage vote required of such class being as follows:

Name of Class	Total Number of Outstanding Shares Entitled to Vote	Percentage Vote Required
Common Stock, $2.00 Par Value	8,303,714	50.1

Dated: September 28, 1989.

Jeffrey Young
Vice President of Finance,
Treasurer and
Chief Financial Officer

William Calfas
Executive Vice President
and Secretary

The undersigned, Jeffrey Young and William Calfas, the Vice President of Finance, Treasurer and Chief Financial Officer, and Executive Vice President and Secretary, respectively, of Products Research & Chemical Corporation, each declares under penalty of perjury that the matters set out in the foregoing Certificate of Approval are true and correct of his own knowledge.

Executed at Glendale, California, on September 28, 1989.

Jeffrey Young

William Calfas

CERTIFICATE OF APPROVAL
OF
COURTAULDS ACQUISITION CORP.
OF
THE AGREEMENT OF MERGER

Derek F. Twogood and Stephen A. Briley, certify that:

1. They are the duly elected and acting President and Secretary, respectively, of Courtaulds Acquisition Corp., a California corporation (hereinafter called "this Corporation").

2. This certificate is attached to the Agreement of Merger, dated as of October 2, 1989, providing for the merger of this Corporation with and into Products Research & Chemical Corporation, a California corporation.

3. The Agreement of Merger in the form attached hereto has been approved by the Board of Directors of this Corporation.

4. The principal terms of the Agreement of Merger in the form attached hereto were approved by this Corporation by the vote of a number of shares of the only outstanding class of stock of this Corporation which equaled or exceeded the vote required, such class, the total number of outstanding shares of such class entitled to vote on the merger, and the percentage vote required of such class being as follows:

Name of Class	Total Number of Outstanding Shares Entitled to Vote	Percentage Vote Required
Common Stock, without par value	100	50.1

[2200-034III/E04/5A/4205]

Dated *September 29*, 1989.

Derek P. Twogood
President

Dated *September 28*, 1989.

Stephen A. Briley
Secretary

[2200-034III/E04/5A/4205]

The undersigned, Derek F. Twogood and Stephen A. Briley, the President and Secretary, respectively, of Courtaulds Acquisition Corp., each declares under penalty of perjury that the matters set out in the foregoing Certificate of Approval are true and correct of his own knowledge.

Executed at New York, New York, on September 29, 1989.

Derek F. Twogood

Executed at Lemoyne, Alabama, on September 28, 1989.

Stephen A. Briley

[2200-034III/E04/5A/4205]

GIBSON, DUNN & CRUTCHER
LAWYERS
2029 CENTURY PARK EAST
LOS ANGELES, CALIFORNIA 90067-3026
(213) 552-8500
TELEX: 674264 GIBTRASKCC LSA
TELECOPIER: (213) 277-5827

LOS ANGELES
333 SOUTH GRAND AVENUE
LOS ANGELES, CALIFORNIA 90071-3197
NEWPORT CENTER
800 NEWPORT CENTER DRIVE
NEWPORT BEACH, CALIFORNIA 92660-6395
SACRAMENTO
1010 F STREET
SACRAMENTO, CALIFORNIA 95814-0826
SAN DIEGO
750 B STREET
SAN DIEGO, CALIFORNIA 92101-4605
SAN FRANCISCO
ONE MONTGOMERY STREET, TELESIS TOWER
SAN FRANCISCO, CALIFORNIA 94104-4505
SAN JOSE
ONE ALMADEN BOULEVARD
SAN JOSE, CALIFORNIA 95113-2267
DALLAS
1700 PACIFIC AVENUE
DALLAS, TEXAS 75201-4618
DENVER
1801 CALIFORNIA STREET
DENVER, COLORADO 80202-2694
SEATTLE
701 FIFTH AVENUE
SEATTLE, WASHINGTON 98104-7089

JAS. A. GIBSON, 1852-1922
W. E. DUNN, 1861-1925
ALBERT CRUTCHER, 1860-1931

NEW YORK
200 PARK AVENUE
NEW YORK, NEW YORK 10166-0193
WASHINGTON
1050 CONNECTICUT AVENUE, N.W.
WASHINGTON, D.C. 20036-5303
EUROPE
104 AVENUE RAYMOND POINCARÉ
75116 PARIS, FRANCE
LONDON
30/35 PALL MALL
LONDON SW1Y 5LP
HONG KONG
1 DUDDELL STREET
HONG KONG
TOKYO
1-1-3 MARUNOUCHI CHIYODA-KU
TOKYO 100 JAPAN
AFFILIATED SAUDI ARABIA OFFICE
CHAMBER OF COMMERCE BUILDING
P.O. BOX 15870
RIYADH 11454, SAUDI ARABIA

October 2, 1989

VIA MESSENGER

WRITER'S DIRECT DIAL NUMBER

(213) 551-8712

OUR FILE NUMBER

C 72414-00002

Office of the Secretary of State
State of California
1230 J Street
Sacramento, California 95814

Re: Merger of Courtaulds Acquisition Corp. with and into Products Research & Chemical Corporation

Gentlemen:

Pursuant to your request, please be advised that the percentage of outstanding shares of Products Research & Chemical Corporation to be cancelled under Section 4(b) of the Agreement of Merger is approximately 94%.

Very truly yours,

Michael B. Maloney

Michael B. Maloney
for Gibson, Dunn & Crutcher

MBM:wpo/5333Q
Enclosure

198097 A413335

CERTIFICATE OF AMENDMENT OF

ARTICLES OF INCORPORATION OF

PRODUCTS RESEARCH & CHEMICAL CORPORATION

FILED
In the office of the Secretary of State
of the State of California

JAN 2 3 1992

March Fong Eu
MARCH FONG EU, Secretary of State

DEAN M. WILLARD and WILLIAM CALFAS certify:

1. That they are the President and Chief Executive Officer and the Secretary, respectively, of PRODUCTS RESEARCH & CHEMICAL CORPORATION, a California corporation.

2. Article FIFTH of the Articles of Incorporation is amended to read:

> "FIFTH: That the number of Directors of the Corporation shall be fixed by a bylaw or amendment thereof duly adopted and approved by the shareholders or by the Board of Directors of this Corporation."

3. The amendment herein set forth has been duly approved by the Board of Directors.

4. The amendment herein set forth has been duly approved by the sole shareholder in accordance with Section 902 of the Corporations Code.

Each of the undersigned declares under penalty of perjury under the laws of the State of California that they have read the foregoing certificate and know the contents thereof and that the same is true of their own knowledge.

Dated: April 1, 1991

Dean M. Willard, President
Chief Executive Officer

William Calfas, Secretary

NCTO:

198097 A416132

FILED
In the office of the Secretary of State of the State of California

APR - 1 1992

March Fong Eu
MARCH FONG EU, Secretary of State

CERTIFICATE OF AMENDMENT OF

ARTICLES OF INCORPORATION OF

PRODUCTS RESEARCH & CHEMICAL CORPORATION

DEAN M. WILLARD and WILLIAM CALFAS certify:

1. That they are the President and Chief Executive Officer and the Secretary, respectively, of PRODUCTS RESEARCH & CHEMICAL CORPORATION, a California corporation.

2. Article FIRST of the Articles of Incorporation is amended to read:

> "FIRST: That the name of this Corporation is COURTAULDS AEROSPACE, INC."

3. The amendment herein set forth has been duly approved by the Board of Directors.

4. The amendment herein set forth has been duly approved by the sole shareholder in accordance with Section 902 of the Corporations Code by unanimous vote of all of the issued and outstanding shares.

Each of the undersigned declares under penalty of perjury under the laws of the State of California that they have read the foregoing certificate and know the contents thereof and that the same is true of their own knowledge.

Dated: March 30, 1992

Dean M. Willard

DEAN M. WILLARD, President
Chief Executive Officer

W Calfas

WILLIAM CALFAS, Secretary

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FILED
Office of the Secretary of State
of the State of California

DEC 1 1998

Bill Jones
JONES Secretary

CERTIFICATE OF AMENDMENT OF

ARTICLES OF INCORPORATION OF

COURTAULDS AEROSPACE, INC.

DAVID P. MORRIS and RICHARD E. HEIMERL certify:

1. That they are the Vice President and the Secretary, respectively, of COURTAULDS AEROSPACE, INC., a California corporation.

2. Article FIRST of the Articles of Incorporation is amended to read:

> "FIRST: That the name of this Corporation is PRC – DESOTO INTERNATIONAL, INC."

3. The amendment herein set forth has been duly approved by the Board of Directors.

4. The foregoing amendment of Articles of Incorporation has been duly approved by the required vote of shareholders in accordance with Section 902, California Corporations Code. The total number of outstanding shares of the corporation is 1,000. The number of shares voting in favor of the amendment equaled or exceeded the vote required. The percentage vote required was more than 50%.

Each of the undersigned declares under penalty of perjury under the laws of the State of California that they have read the foregoing certificate and know the contents thereof and that the same is true of their own knowledge.

Dated: November 30, 1998

David P Morris

DAVID P. MORRIS, Vice President

RICHARD E. HEIMERL, Secretary

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FILED
In the office of the Secretary of State of the State of California

APR 12 2000

Secretary of State

CERTIFICATE OF OWNERSHIP
OF
PRC-DeSOTO CDP, INC.
INTO
PRC-DeSOTO INTERNATIONAL, INC.

To the Secretary of State
State of California

Pursuant to the provisions of the General Corporation Law of the State of California, the undersigned officers of the domestic parent corporation hereinafter named do hereby certify as follows:

1. The name of the parent corporation, which is a business corporation of the State of California, and which is to be the surviving corporation under the merger herein certified, is PRC-DeSoto International, Inc.

2. The name of the subsidiary corporation, which is a business corporation of the State of Delaware, and which is to be the disappearing corporation under the merger herein certified, is PRC-DeSoto CDP, Inc.

3. PRC-DeSoto International, Inc. owns 100% of the outstanding shares of PRC-DeSoto CDP, Inc.

4. The following is a copy of the resolutions to merge PRC-DeSoto CDP, Inc. into PRC-DeSoto International, Inc. as adopted and approved by the Board of Directors of PRC-DeSoto International, Inc.:

"RESOLVED, that, PRC-DeSoto International, Inc., which is a business corporation of the State of California and is the owner of all of the outstanding shares of PRC-DeSoto CDP, Inc.. which is a business corporation of the State of Delaware, does hereby merge PRC-DeSoto CDP, Inc. into PRC-DeSoto International, Inc. pursuant to the provisions of the General Corporation Law of the State of Delaware and pursuant to the provisions of the General Corporation Law of the State of California and does hereby assume all of the liabilities of PRC-DeSoto CDP, Inc.;

RESOLVED, that PRC-DeSoto CDP, Inc. shall be the disappearing corporation upon the effective date of the merger herein provided for pursuant to the provisions of the General Corporation Law of the State of Delaware and PRC-DeSoto International, Inc. shall continue its existence as the surviving corporation pursuant to the provisions of the General Corporation Law of the State of California:

RESOLVED, that the issued shares of PRC-DeSoto CDP, Inc. shall not be converted in any manner, not shall any cash or other consideration be paid or delivered therefore, inasmuch as PRC-DeSoto International, Inc. is the owner of all outstanding shares of PRC-DeSoto CDP, Inc., but each said share which is issued as of the complete effective date of the merger shall be surrendered and extinguished; and

RESOLVED, that the Board of Directors and the proper officers of PRC-DeSoto International, Inc. are hereby authorized, empowered, and directed to do any and all acts and things, and to make, execute, deliver, file and/or record any and all instruments, papers, and documents which shall be or become necessary, proper, or convenient to carry out or put into effect any of the provisions of the merger herein provided for."

On the date set forth below, in the City of Glendale in the State of California, each of the undersigned does hereby declare under the penalty of perjury under the laws of the State of California that he signed the foregoing certificate in the official capacity set forth beneath his signature, and that the statements set forth in said certificate are true of his own knowledge.

Signed on: February 9, 2000

Dennis Kovalsky, President

John Machin, Vice President and
Assistant Secretary

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
100 F ST., N.E.
WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2012,

OR

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE TRANSITION PERIOD FROM TO

Commission File Number	Registrants, State of Incorporation, Address, and Telephone Number	I.R.S. Employer Identification No.
001-09120	PUBLIC SERVICE ENTERPRISE GROUP INCORPORATED (A New Jersey Corporation) 80 Park Plaza, P.O. Box 1171 Newark, New Jersey 07101-1171 973 430-7000 http://www.pseg.com	22-2625848
001-34232	PSEG POWER LLC (A Delaware Limited Liability Company) 80 Park Plaza—T25 Newark, New Jersey 07102-4194 973 430-7000 http://www.pseg.com	22-3663480
001-00973	PUBLIC SERVICE ELECTRIC AND GAS COMPANY (A New Jersey Corporation) 80 Park Plaza, P.O. Box 570 Newark, New Jersey 07101-0570 973 430-7000 http://www.pseg.com	22-1212800

Securities registered pursuant to Section 12(b) of the Act:

Registrant	Title of Each Class	Name of Each Exchange On Which Registered
Public Service Enterprise Group Incorporated	Common Stock without par value	New York Stock Exchange
PSEG Power LLC	8 5/8% Senior Notes, due 2031	New York Stock Exchange
	First and Refunding Mortgage Bonds	
Public Service Electric and Gas Company	9 1/4% Series CC, due 2021 6 3/4% Series VV, due 2016 8%, due 2037 5%, due 2037	New York Stock Exchange

(Cover continued on next page)

(Cover continued from previous page)

Securities registered pursuant to Section 12(g) of the Act:

Registrant	Title of Each Class
PSEG Power LLC	Limited Liability Company Membership Interest
Public Service Electric and Gas Company	Medium-Term Notes

Indicate by check mark whether each registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Public Service Enterprise Group Incorporated	Yes ☒	No ☐
PSEG Power LLC	Yes ☐	No ☒
Public Service Electric and Gas Company	Yes ☒	No ☐

Indicate by check mark if each of the registrants is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes ☐ No ☒

Indicate by check mark whether each of the registrants (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrants were required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrants have submitted electronically and posted on their corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrants were required to submit and post such files). Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

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

Public Service Enterprise Group Incorporated	Large accelerated filer ☒	Accelerated filer ☐	Non-accelerated filer ☐
PSEG Power LLC	Large accelerated filer ☐	Accelerated filer ☐	Non-accelerated filer ☒
Public Service Electric and Gas Company	Large accelerated filer ☐	Accelerated filer ☐	Non-accelerated filer ☒

Indicate by check mark whether any of the registrants is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

The aggregate market value of the Common Stock of Public Service Enterprise Group Incorporated held by non-affiliates as of June 30, 2012 was $16,420,936,616 based upon the New York Stock Exchange Composite Transaction closing price.

The number of shares outstanding of Public Service Enterprise Group Incorporated's sole class of Common Stock as of January 31, 2013 was 505,959,216.

As of January 31, 2013, Public Service Electric and Gas Company had issued and outstanding 132,450,344 shares of Common Stock, without nominal or par value, all of which were privately held, beneficially and of record by Public Service Enterprise Group Incorporated.

PSEG Power LLC and Public Service Electric and Gas Company are wholly owned subsidiaries of Public Service Enterprise Group Incorporated and each meet the conditions set forth in General Instruction I(1)(a) and (b) of Form 10-K. Each is filing its Annual Report on Form 10-K with the reduced disclosure format authorized by General Instruction I.

DOCUMENTS INCORPORATED BY REFERENCE

Part of Form 10-K of Public Service Enterprise Group Incorporated	Documents Incorporated by Reference
III	Portions of the definitive Proxy Statement for the 2013 Annual Meeting of Stockholders of Public Service Enterprise Group Incorporated, which definitive Proxy Statement is expected to be filed with the Securities and Exchange Commission on or about March 8, 2013, as specified herein.

TABLE OF CONTENTS

FORWARD-LOOKING STATEMENTS

Certain of the matters discussed in this report constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements are subject to risks and uncertainties, which could cause actual results to differ materially from those anticipated. Such statements are based on management's beliefs as well as assumptions made by and information currently available to management. When used herein, the words "anticipate," "intend," "estimate," "believe," "expect," "plan," "should," "hypothetical," "potential," "forecast," "project," variations of such words and similar expressions are intended to identify forward-looking statements. Factors that may cause actual results to differ are often presented with the forward-looking statements themselves. Other factors that could cause actual results to differ materially from those contemplated in any forward-looking statements made by us herein are discussed in Item 1A. Risk Factors, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A), Item 8. Financial Statements and Supplementary Data —Note 13. Commitments and Contingent Liabilities, and other factors discussed in filings we make with the United States Securities and Exchange Commission (SEC). These factors include, but are not limited to:

- adverse changes in the demand for or the price of the capacity and energy that we sell into wholesale electricity markets,
- adverse changes in energy industry law, policies and regulation, including market structures and a potential shift away from competitive markets toward subsidized market mechanisms, transmission planning and cost allocation rules, including rules regarding how transmission is planned and who is permitted to build transmission in the future, and reliability standards,
- any inability of our transmission and distribution businesses to obtain adequate and timely rate relief and regulatory approvals from federal and state regulators,
- changes in federal and state environmental regulations that could increase our costs or limit our operations,
- changes in nuclear regulation and/or general developments in the nuclear power industry, including various impacts from any accidents or incidents experienced at our facilities or by others in the industry, that could limit operations of our nuclear generating units,
- actions or activities at one of our nuclear units located on a multi-unit site that might adversely affect our ability to continue to operate that unit or other units located at the same site,
- any inability to balance our energy obligations, available supply and risks,
- any deterioration in our credit quality or the credit quality of our counterparties, including in our leveraged leases,
- availability of capital and credit at commercially reasonable terms and conditions and our ability to meet cash needs,
- changes in the cost of, or interruption in the supply of, fuel and other commodities necessary to the operation of our generating units,
- delays in receipt of necessary permits and approvals for our construction and development activities,
- delays or unforeseen cost escalations in our construction and development activities,
- any inability to achieve, or continue to sustain, our expected levels of operating performance,
- any equipment failures, accidents, severe weather events or other incidents that impact our ability to provide safe and reliable service to our customers,
- increase in competition in energy supply markets as well as competition for certain rate-based transmission projects,
- any inability to realize anticipated tax benefits or retain tax credits,
- challenges associated with recruitment and/or retention of a qualified workforce,
- adverse performance of our decommissioning and defined benefit plan trust fund investments and changes in funding requirements, and
- changes in technology and customer usage patterns.

All of the forward-looking statements made in this report are qualified by these cautionary statements and we cannot assure you that the results or developments anticipated by management will be realized or, even if realized, will have the expected consequences to, or effects on, us or our business prospects, financial condition or results of operations. Readers are cautioned not to place undue reliance on these forward-looking statements in making any investment decision. Forward-looking statements made in this report apply only as of the date of this report. While we may elect to update forward-looking statements from time to time, we specifically disclaim any obligation to do so, even if internal estimates change, unless otherwise required by applicable securities laws.

The forward-looking statements contained in this report are intended to qualify for the safe harbor provisions of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended.

FILING FORMAT AND GLOSSARY

This combined Annual Report on Form 10-K is separately filed by Public Service Enterprise Group Incorporated (PSEG), PSEG Power LLC (Power) and Public Service Electric and Gas Company (PSE&G). Information relating to any individual company is filed by such company on its own behalf. Power and PSE&G are each only responsible for information about itself and its subsidiaries.

Discussions throughout the document refer to PSEG and its direct operating subsidiaries, Power, PSE&G and PSEG Energy Holdings L.L.C. (Energy Holdings). Depending on the context of each section, references to "we," "us," and "our" relate to the specific company or companies being discussed. In addition, certain key acronyms and definitions are summarized in a glossary beginning on page 191.

WHERE TO FIND MORE INFORMATION

We file annual, quarterly and special reports, proxy statements and other information with the SEC. You may read and copy any document that we file at the Public Reference Room of the SEC at 100 F Street, N.E., Washington, D.C. 20549. Information on the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330. You may also obtain our filed documents from commercial document retrieval services, the SEC's internet website at www.sec.gov or our website at www.pseg.com. Information on our website should not be deemed incorporated into or as a part of this report. Our Common Stock is listed on the New York Stock Exchange under the ticker symbol PEG. You can obtain information about us at the offices of the New York Stock Exchange, Inc., 20 Broad Street, New York, New York 10005.

PART I

ITEM 1. BUSINESS

We were incorporated under the laws of the State of New Jersey in 1985 and our principal executive offices are located at 80 Park Plaza, Newark, New Jersey 07102. We conduct our business through three direct wholly owned subsidiaries, Power, PSE&G and Energy Holdings, each of which also has its principal executive offices at 80 Park Plaza, Newark, New Jersey 07102. PSEG Services Corporation (Services), our other wholly owned subsidiary, provides us and these operating subsidiaries with certain management, administrative and general services at cost.

We are an energy company with a diversified business mix. Our operations are located primarily in the Northeastern and Mid- Atlantic United States. Our business approach focuses on operational excellence, financial strength and disciplined investment. As a holding company, our profitability depends on our subsidiaries' operating results. Below are descriptions of our direct operating subsidiaries.

Power	PSE&G	Energy Holdings
A Delaware limited liability company formed in 1999 that integrates its generating asset operations with its wholesale energy sales, fuel supply and energy trading functions. Earns revenues from selling under contract or on the spot market a range of diverse products such as electricity, natural gas, capacity, emissions credits and a series of energy-related products used to optimize the operation of the energy grid.	A New Jersey corporation, incorporated in 1924, which is a franchised public utility in New Jersey. It is also the provider of last resort for gas and electric commodity service for end users in its service territory. Earns revenues from its regulated rate tariffs under which it provides electric transmission and electric and gas distribution to residential, commercial and industrial customers in its service territory. It also offers appliance services and repairs to customers throughout its service territory. Has also implemented demand response and energy efficiency programs and invested in solar generation within New Jersey.	A New Jersey limited liability company (successor to a corporation which was formed in 1989) that invests and operates through its two primary subsidiaries. Earns revenues primarily from its portfolio of lease investments and its solar generation projects.

The following is a more detailed description of our business, including a discussion of our:

- Business Operations and Strategy
- Competitive Environment
- Employee Relations
- Regulatory Issues
- Environmental Matters

BUSINESS OPERATIONS AND STRATEGY

Power

Through Power, we seek to produce low-cost energy by efficiently operating our nuclear, coal, gas and oil-fired generation facilities, while balancing generation production, fuel requirements and supply obligations through energy portfolio management. We use commodity contracts and financial instruments, combined with our owned generation, to cover our commitments for Basic Generation Service (BGS) in New Jersey and other bilateral supply contract agreements.

Products and Services

As a merchant generator, our profit is derived from selling a range of products and services under contract to power marketers and to others, such as investor-owned and municipal utilities, and to aggregators who resell energy to retail consumers, or in the spot market. These products and services include:

- **Energy**—the electrical output produced by generation plants that is ultimately delivered to customers for use in lighting, heating, air conditioning and operation of other electrical equipment. Energy is our principal product and is priced on a usage basis, typically in cents per kilowatt hour (kWh) or dollars per megawatt hour (MWh).
- **Capacity**—a product distinct from energy, is a market commitment that a given generation unit will be available to an Independent System Operator (ISO) for dispatch if it is needed to meet system demand. Capacity is typically priced in dollars per megawatt (MW) for a given sale period.
- **Ancillary Services**—related activities supplied by generation unit owners to the wholesale market, required by the ISO to ensure the safe and reliable operation of the bulk power system. Owners of generation units may bid units into the ancillary services market in return for compensatory payments. Costs to pay generators for ancillary services are recovered through charges imposed on market participants.
- **Emissions Allowances and Congestion Credits** —Emissions allowances (or credits) represent the right to emit a specific amount of certain pollutants. Allowance trading is used to control air pollution by providing economic incentives for achieving reductions in the emissions of pollutants. Congestion credits (or Financial Transmission Rights) are financial instruments that entitle the holder to a stream of revenues (or charges) based on the hourly congestion price differences across a transmission path.

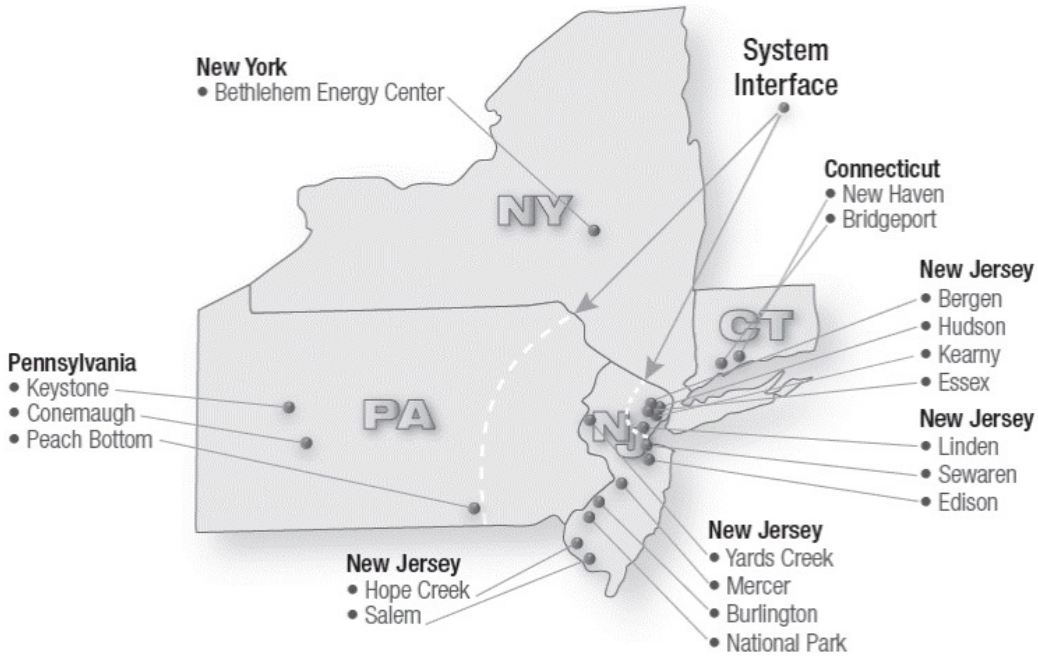
Power also sells wholesale natural gas, primarily through a full requirements Basic Gas Supply Service (BGSS) contract with PSE&G to meet the gas supply requirements of PSE&G's customers. This long-term contract was for an initial period which extended through March 31, 2012 and continues on a year-to-year basis thereafter, unless terminated by either party with a one year notice.

Approximately 46% of PSE&G’s peak daily gas requirements is provided from Power’s firm transportation capacity, which is available every day of the year. Power satisfies the remainder of PSE&G’s requirements from storage contracts, liquefied natural gas, seasonal purchases, contract peaking supply, propane and refinery gas. Based upon availability, Power also sells gas to others.

How Power Operates

We own approximately 13,226 MW of generation capacity located in the Northeast and Mid-Atlantic regions of the United States in some of the country’s largest and most developed electricity markets.

The map below shows the locations of our Northeast and Mid-Atlantic generation facilities



- **Generation Capacity**

Power has approved the expenditure of approximately $192 million for a steam path retrofit and related upgrades at its co-owned Peach Bottom Units 2 and 3. Unit 3 upgrades were completed in October 2011. Unit 2 upgrades were completed in October 2012. The balance of work to ensure efficient operation is expected to be completed by 2014. Total expenditures through December 31, 2012 were $154 million.

Power has also approved the expenditure of $419 million for an extended power uprate of the Peach Bottom nuclear units. The uprate is expected to result in an increase in Power's share of nominal capacity by approximately 130 MW. The uprate is expected to be in service in 2015 for Unit 2 and 2016 for Unit 3. Total expenditures through December 31, 2012 were $73 million.

In 2011, we sold 2,000 MW of generation facilities we owned and operated in Texas. See Item 8. Financial Statements and Supplementary Data—Note 1. Organization, Basis of Presentation and Summary of Significant Accounting Policies and Note 4. Discontinued Operations and Dispositions, for additional information.

For additional information on each of our generation facilities, see Item 2. Properties.

Our installed capacity utilizes a diverse mix of fuels: 45% gas, 28% nuclear, 18% coal, 8% oil and 1% pumped storage. This fuel diversity helps to mitigate risks associated with fuel price volatility and market demand cycles. Our total generating output in 2012 was approximately 53,000 gigawatt hours (GWh). The generation mix by fuel type has changed slightly in recent years due to the relatively favorable price of natural gas as compared to coal, making it more economical to run certain of our gas units than our coal units. The following table indicates the proportionate share of generating output by fuel type.

Generation by Fuel Type	Actual 2012	
Nuclear:		
New Jersey facilities	39%	
Pennsylvania facilities	18%	
Fossil:		
Coal:		
Pennsylvania facilities	9%	
Connecticut facilities	—%	(A)
Coal and Natural Gas:		
New Jersey facilities	2%	
Oil and Natural Gas:		
New Jersey facilities	23%	
New York facilities	9%	
Connecticut facilities	—%	(A)
Total	**100%**	

(A) Less than one percent.

- **Generation Dispatch**

Our generation units are typically characterized as serving one or more of three general energy market segments: base load; load following; and peaking, based on their operating capability and performance. On a capacity basis, our portfolio of generation assets consists of 33% base load, 43% load following and 24% peaking. This diversity helps to reduce the risk associated with market demand cycles and allows us to participate in the market at each segment of the dispatch curve.

- **Base Load Units** run the most and typically operate whenever they are available. These units generally derive revenues from energy and capacity sales. Variable operating costs are low due to the combination of highly efficient operations and the use of relatively lower-cost fuels. Performance is generally measured by the unit's "capacity factor," or the ratio of the actual output to the theoretical maximum output. In 2012, our base load capacity factors were as follows:

Unit	2012 Capacity Factor
Nuclear	
Salem Unit 1	95.2%
Salem Unit 2	87.3%
Hope Creek	89.8%
Peach Bottom Unit 2	85.9%
Peach Bottom Unit 3	99.0%
Coal	
Keystone	63.8%
Conemaugh	71.3%

No assurances can be given that these capacity factors will be achieved in the future.

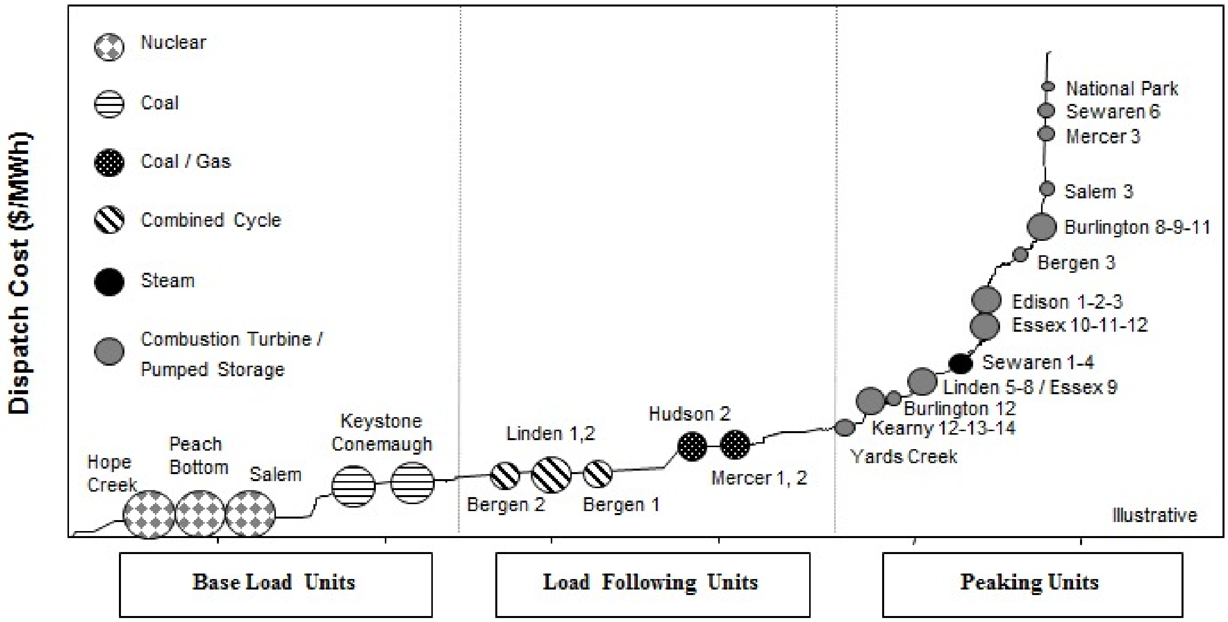
- **Load Following Units** typically operate between 20% and 80% of the time. The operating costs are higher per unit of output due to lower efficiency and/or the use of higher-cost fuels such as oil, natural gas and, in some cases, coal. They operate less frequently than base load units and derive revenues from energy, capacity and ancillary services.
- **Peaking Units** run the least amount of time and utilize higher-priced fuels. These units typically operate less than 20% of the time. Costs per unit of output tend to be much higher than for base load units. The majority of

revenues are from capacity and ancillary service sales. The characteristics of these units enable them to capture energy revenues during periods of high energy prices.

In the energy markets in which we operate, owners of power plants specify to the ISO prices at which they are prepared to generate and sell energy based on the marginal cost of generating energy from each individual unit. The ISOs will dispatch in merit order, calling on the lowest variable cost units first and dispatching progressively higher-cost units until the point that the entire system demand for power (known as the system "load") is satisfied. Base load units are dispatched first, with load following units next, followed by peaking units.

During periods when one or more parts of the transmission grid are operating at full capability, thereby resulting in a constraint on the transmission system, it may not be possible to dispatch units in merit order without violating transmission reliability standards. Under such circumstances, the ISO will dispatch higher-cost generation out of merit order within the congested area and power suppliers will be paid an increased Locational Marginal Price (LMP) in congested areas, reflecting the bid prices of those higher-cost generation units.

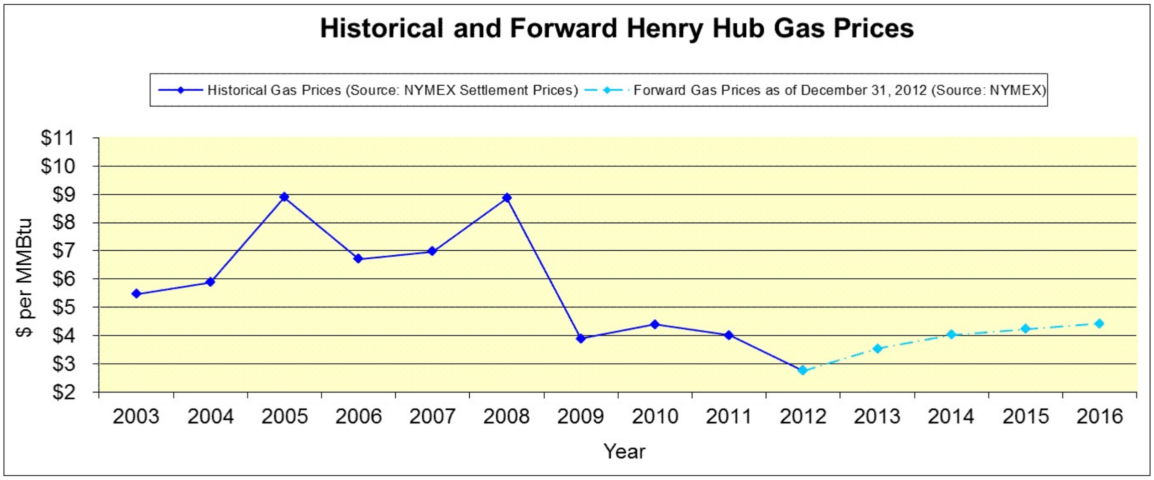
The following chart depicts the merit order of dispatch of our units in PJM Interconnection L.L.C. (PJM), where most of our generation units are located, based on illustrative historical dispatch cost. It should be noted that market price fluctuations have resulted in changes from historical norms, with lower gas prices allowing some gas generation to displace some coal generation.

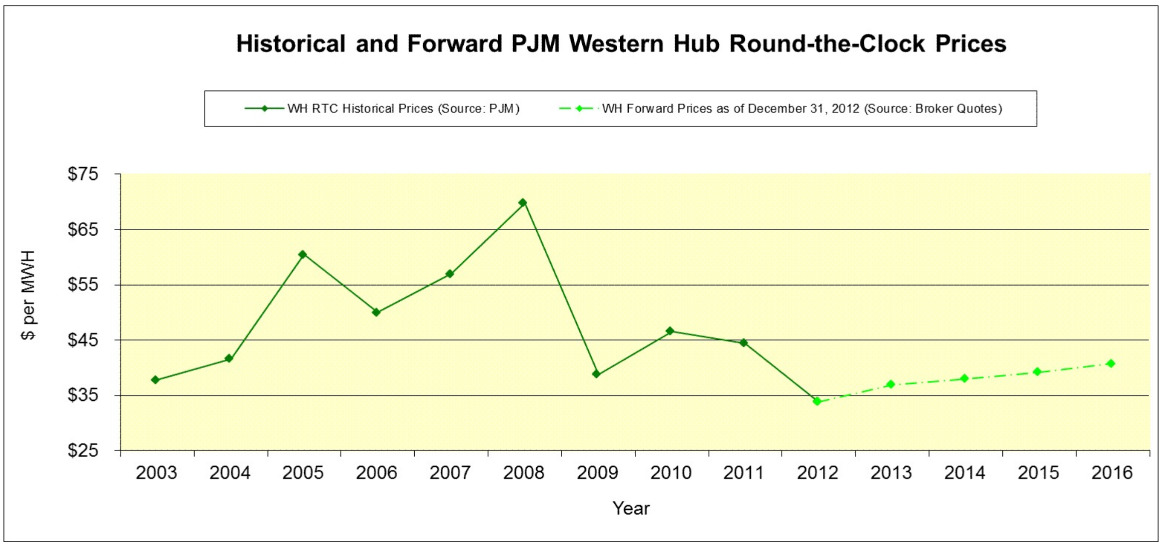


The size of each facility's fuel circle in the above chart illustrates the relative MW capacity of the generating capacity of that facility. For additional information on each of our generation facilities, see Item 2. Properties.

The bid price of the last unit dispatched by an ISO establishes the energy market-clearing price. After considering the market-clearing price and the effect of transmission congestion and other factors, the ISO calculates the LMP for every location in the system. The ISO pays all units that are dispatched their respective LMP for each MWh of energy produced, regardless of their specific bid prices. Since bids generally approximate the marginal cost of production, units with lower marginal costs typically generate higher operating profits than units with comparatively higher marginal costs.

This method of determining supply and pricing creates an environment in the markets such that natural gas prices often have a major impact on the price that generators will receive for their output, especially in periods of relatively strong demand. Therefore, significant changes in the price of natural gas will often translate into significant changes in the wholesale price of electricity. This can be seen in the following graphs which present historical annual spot prices and forward calendar prices as averaged over each year.





Historical data and forward prices would imply that the price of natural gas will continue to have a strong influence on the price of electricity in the primary markets in which we operate.

The prices reflected in the tables above do not necessarily illustrate our contract prices, but they are representative of market prices at relatively liquid hubs, with nearer-term forward pricing generally resulting from more liquid markets than pricing for later years. In addition, the prices do not reflect locational differences resulting from congestion or other factors, which can be considerable. While these prices provide some perspective on past and future prices, the forward prices are highly volatile and there can be no assurance that such prices will remain in effect or that we will be able to contract output at these forward prices.

Fuel Supply

- ***Nuclear Fuel Supply***—To run our nuclear units we have long-term contracts for nuclear fuel. These contracts provide for:
  - purchase of uranium (concentrates and uranium hexafluoride),
  - conversion of uranium concentrates to uranium hexafluoride,
  - enrichment of uranium hexafluoride, and
  - fabrication of nuclear fuel assemblies.

- ***Coal Supply***—Coal is the primary fuel for our Keystone, Conemaugh and Bridgeport stations. Coal is also used by Hudson and Mercer which operate on both coal and natural gas. We have coal contracts with numerous suppliers. Coal is delivered to our units through a combination of rail, truck, barge or ocean shipments.

  In order to minimize emissions levels, our Bridgeport 3 unit uses a specific type of coal obtained from Indonesia. If the supply from Indonesia or equivalent coal from other sources was not available for this facility, its long-term operations would be adversely impacted since additional material capital expenditures would be required to modify our Bridgeport 3 station to enable it to operate using a broader mix of coal sources.
- ***Gas Supply***—Natural gas is the primary fuel for the bulk of our load following and peaking fleet. We purchase gas directly from natural gas producers and marketers. These supplies are transported to New Jersey by four interstate pipelines with whom we have contracted. In addition, we have firm gas transportation contracts to serve our Bethlehem Energy Center (BEC) in New York.

  We have 1.3 billion cubic feet-per-day of firm transportation capacity under contract to meet our obligations under the BGSS contract. On an as available basis, this firm transportation capacity may also be used to serve the gas supply needs of our generation fleet. We supplement that supply with a total storage capacity of 76 billion cubic feet.
- ***Oil***—Oil is used as the primary fuel for one load following steam unit and nine combustion turbine peaking units and can be used as an alternate fuel by several load following and peaking units that have dual-fuel capability. Oil for operations is drawn from on-site storage and is generally purchased on the spot market and delivered by truck, barge or pipeline.

We expect to be able to meet the fuel supply demands of our customers and our own operations. However, the ability to maintain an adequate fuel supply could be affected by several factors not within our control, including changes in prices and demand, curtailments by suppliers, severe weather and other factors. For additional information, see Item 7. Management's Discussion and Analysis (MD&A)—Overview of 2012 and Future Outlook and Item 8. Financial Statements and Supplementary Data -Note 13. Commitments and Contingent Liabilities.

Markets and Market Pricing

Power’s generation assets are located in three centralized, competitive electricity markets operated by ISO organizations all of which are subject to the regulatory oversight of the Federal Energy Regulatory Commission (FERC):

- **PJM Regional Transmission Organization**—PJM conducts the largest centrally dispatched energy market in North America. It serves over 60 million people, nearly 20% of the total United States population, and has a peak demand of over 163,848 MW. The PJM Interconnection coordinates the movement of electricity through all or parts of Delaware, Illinois, Indiana, Kentucky, Maryland, Michigan, New Jersey, North Carolina, Ohio, Pennsylvania, Tennessee, Virginia, West Virginia and the District of Columbia. The majority of our generating stations operate in PJM.
- **New York**—The NYISO is the market coordinator for New York State and is responsible for managing the New York Power Pool and for administering its energy marketplace. This service area has a population of about 19 million and a peak demand of over 33,939 MW. Our BEC station operates in New York.
- **New England**—ISO-NE coordinates the movement of electricity in a region covering Maine, New Hampshire, Vermont, Massachusetts, Connecticut and Rhode Island. This service area has a population of about 14 million and a peak demand of over 28,130 MW. Our Bridgeport and New Haven stations operate in Connecticut.

The price of electricity varies by location in each of these markets. Depending upon our production and our obligations, these price differentials can serve to increase or decrease our profitability.

Commodity prices, such as electricity, gas, coal, oil and emissions, as well as the availability of our diverse fleet of generation units to produce these products, also have a considerable effect on our profitability. These commodity prices have been, and continue to be, subject to significant market volatility. Over the long-term, the higher the forward prices are, the more attractive an environment exists for us to contract for the sale of our anticipated output. However, higher prices also increase the cost of replacement power; thereby placing us at greater risk should our generating units fail to function effectively or otherwise become unavailable.

Over the past few years, a decline in wholesale natural gas prices has resulted in lower electricity prices. One of the reasons for the decline in natural gas prices is greater supply from shale production. This trend has reduced margin on forward sales as we re-contract our expected generation output.

In addition to energy sales, we also earn revenue from capacity payments for our generating assets. These payments are compensation for committing a portion of our capacity to the ISO for dispatch at its discretion. Capacity payments reflect the value to the ISO of assurance that there is sufficient generating capacity available at all times to meet system reliability and energy requirements. Currently, there is sufficient capacity in the markets in which we operate. However, in certain areas of these markets there are transmission system constraints, raising concerns about reliability and creating a more acute need for capacity.

In PJM and ISO-NE, where we operate most of our generation, the market design for capacity payments provides for a structured, forward-looking, transparent capacity pricing mechanism. This is through the Reliability Pricing Model (RPM) in PJM and the Forward Capacity Market (FCM) in ISO-NE. These mechanisms provide greater transparency regarding the value of capacity, resulting in an improved pricing signal to prospective investors in new generating facilities so as to encourage expansion of capacity to meet future market demands.

The prices to be received by generating units in PJM for capacity have been set through RPM base residual auctions and depend upon the zone in which the generating unit is located. The majority of our PJM generating units are located in zones where the following prices have been set:

Delivery Year	MW-day	kW-yr
June 2012 to May 2013	$ 139.73	$ 51.70
June 2013 to May 2014	$ 245.00	$ 89.43
June 2014 to May 2015	$ 136.50	$ 49.82
June 2015 to May 2016	$ 167.46	$ 61.12

For each delivery year, the prices differ in the various areas of PJM, depending on the constraints in each area of the transmission system. Keystone and Conemaugh receive lower prices than the majority of our PJM generating units since there are fewer constraints in that region and our generating units in northern New Jersey usually receive higher pricing.

The price that must be paid by an entity serving load in the various zones is also set through these auctions. These prices can be higher or lower than the prices noted in the table above due to import and export capability to and from lower-priced areas.

Like PJM and ISO-NE, the NYISO provides capacity payments to its generating units, but unlike the other two markets, the New York market does not provide a forward price signal beyond a six month auction period.

On a prospective basis, many factors may affect the capacity pricing, including but not limited to:

- changes in load and demand,
- changes in the available amounts of demand response resources,
- changes in available generating capacity (including retirements, additions, derates, forced outages, etc.),
- increases in transmission capability between zones,
- changes to the pricing mechanism, including potentially increasing the number of zones to create more pricing sensitivity to changes in supply and demand, as well as other potential changes that PJM and the other ISOs may propose over time, and
- changes driven by legislative and/or regulatory action, that permit states to subsidize local electric power generation.

For additional information on the RPM and FCM markets, as well as on state subsidization through various mechanisms, see Regulatory Issues—Federal Regulation.

Hedging Strategy

In an attempt to mitigate volatility in our results, we seek to contract in advance for a significant portion of our anticipated electric output, capacity and fuel needs. We seek to sell a portion of our anticipated lower-cost generation over a multi-year forward horizon, normally over a period of two to three years. We believe this hedging strategy increases stability of earnings.

Among the ways in which we hedge our output are: (1) sales at PJM West and (2) BGS contracts. Sales at PJM West reflect block energy sales at the liquid PJM Western Hub and other transactions that seek to secure price certainty for our generation related products. In addition, the BGS-Fixed Price contract, a full requirements contract that includes energy and capacity, ancillary and other services, is awarded for three-year periods through an auction process managed by the New Jersey Board of Public Utilities (BPU). The volume of BGS contracts and the electric utilities that our generation operations serve will vary from year to year. Pricing for the BGS contracts, including a capacity component, for recent and future periods by purchasing utility is as follows:

Load Zone ($/MWh)	2009-2012	2010-2013	2011-2014	2012-2015	2013-2016
PSE&G	$103.72	$95.77	$94.30	$83.88	$92.18
Jersey Central Power & Light	$103.51	$95.17	$92.56	$81.76	$83.70
Atlantic City Electric	$105.36	$98.56	$100.95	$85.10	$87.27
Rockland Electric Company	$112.70	$103.32	$106.84	$92.51	$92.58

We have obtained price certainty for all of our PJM and New England capacity through May 2016 through the RPM and FCM pricing mechanisms.

Although we enter into these hedges in an effort to provide price certainty for a large portion of our anticipated generation, there is variability in both our actual output as well as in our hedges. Our actual output will vary based upon total market demand, the relative cost position of our units compared to all units in the market and the operational flexibility of our units. Our hedge volume can also vary, depending on the type of hedge into which we have entered. The BGS auction, for example, results in a contract that provides for the supplier to serve a percentage of the default load of a New Jersey electric distribution company (EDC), that is, the load that remains after some customers have chosen to be served directly by third party suppliers. The amount of power supplied through the BGS auction varies based on the level of the EDC's default load, which is affected by the number of customers who choose a third party supplier, as well as by other factors such as weather and the economy.

Historically, the number of customers that have switched to third party suppliers was relatively constant, but in recent years, as market prices declined from past years' historic highs, there was additional incentive for more of the smaller commercial and industrial electric customers to switch. In a falling price environment, this has a negative impact on our margins, as the anticipated BGS pricing is replaced by lower spot market pricing. While this impact has been reduced as average BGS rates have declined to a level more closely resembling current market prices, customers may still see an incentive to switch to third party suppliers. We are unable to determine the degree to which this switching, or “migration,” will continue, but the impact on our results could be material.

As of February 6, 2013, we had contracted for the following percentages of our anticipated base load generation output for the next three years with modest amounts beyond 2015.

Base Load Generation	2013	2014	2015
Generation Sales	100%	80%-85%	40%-45%

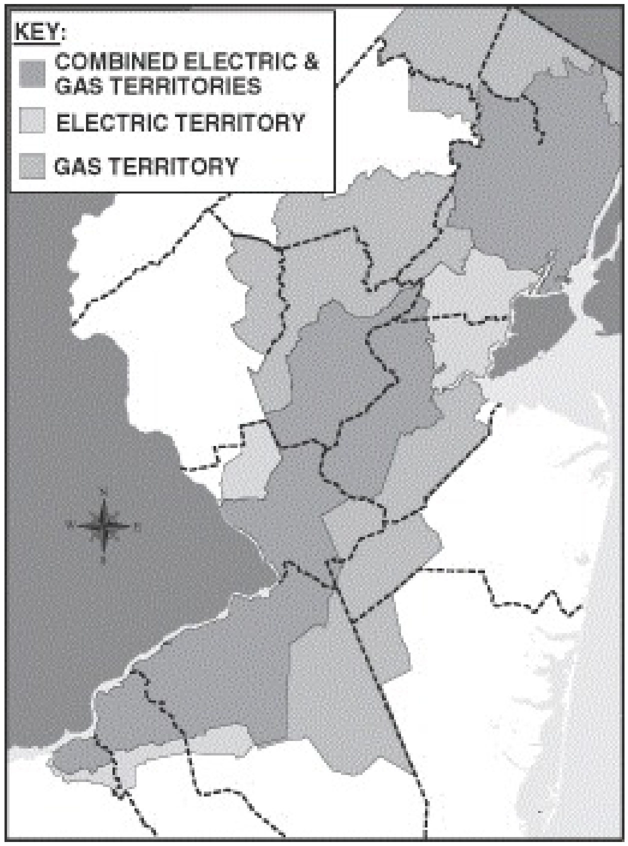
Our strategy is to maintain certain levels of uranium in inventory and to make periodic purchases to support such levels. Our nuclear fuel commitments cover approximately 100% of its estimated uranium, enrichment and fabrication requirements for the three years. We also have various long-term fuel purchase commitments for coal to support our fossil generation stations. These purchase obligations are consistent with our strategy to enter into contracts for its fuel supply in comparable volumes to its sales contracts.

We take a more opportunistic approach in hedging our anticipated natural gas-fired generation. The generation from these units is less predictable, as a significant portion of these units will only dispatch when aggregate market demand has exceeded the supply provided by lower-cost units.

In a changing market environment, this hedging strategy may cause our realized prices to differ materially from current market prices. In a rising price environment, this strategy normally results in lower margins than would have been the case if little or no hedging activity had been conducted. Alternatively, in a falling price environment, this hedging strategy will tend to create margins higher than those implied by the then current market.

PSE&G

Our public utility, PSE&G, distributes electric energy and gas to customers within a designated service territory running diagonally across New Jersey where approximately 6.2 million people, or about 70% of New Jersey's population resides.



Products and Services

Our utility operations primarily earn margins through the transmission and distribution of electricity and the distribution of gas.

- **Transmission**—the movement of electricity at high voltage from generating plants to substations and transformers, where it is then reduced to a lower voltage for distribution to homes, businesses and industrial customers. Our revenues for these services are based upon tariffs approved by the FERC.
- **Distribution**—the delivery of electricity and gas to the retail customer's home, business or industrial facility. Our revenues for these services are based upon tariffs approved by the BPU.

We also earn margins through competitive services, such as appliance repair. The commodity portion of our utility business' electric and gas sales is managed by BGS and BGSS suppliers. Pricing for those services are set by the BPU as a pass-through, resulting in no margin for our utility operations.

In addition to our current utility products and services, we have implemented several programs to increase the level of solar generation including:

- a program to help finance the installation of solar power systems throughout our electric service area, and
- a program to develop, own and operate solar power systems.

We have also implemented a set of energy efficiency and demand response programs to encourage conservation and energy efficiency by providing energy and cost saving measures directly to businesses and families. For additional information concerning these programs and the components of our tariffs, see Regulatory Issues.

How PSE&G Operates

We provide network transmission and point-to-point transmission services, which are coordinated with PJM, and provide distribution service to 2.2 million electric customers and 1.8 million gas customers in a service area that covers approximately 2,600 square miles running diagonally across New Jersey. We serve the most heavily populated, commercialized and industrialized territory in New Jersey, including its six largest cities and approximately three hundred suburban and rural communities.

Transmission

We use formula rates for our transmission investments. Formula-type rates provide a method of rate recovery where the transmission owner annually determines its revenue requirements through a fixed formula which considers Operations and Maintenance expenditures, Rate Base and capital investments and applies an approved return on equity (ROE) in developing the weighted average cost of capital. Our approved rates provide for a base ROE of 11.68% on existing and new transmission investment, while certain investments are entitled to earn an additional incentive rate. For more information on current transmission construction activities, see Regulatory Issues, Federal Regulation—Transmission Regulation.

Transmission Statistics

December 31, 2012		
Network Circuit Miles	**Billing Peak (MW)**	**Historical Annual Load Growth 2008-2012**
1,461	10,470	0.4%

Distribution

The primary business of our utility is the distribution of gas and electricity to end users in our service territory. Our load requirements were split among residential, commercial and industrial customers, as described below for 2012. We believe that we have all the franchise rights (including consents) necessary for our electric and gas distribution operations in the territory we serve.

	% of 2012 Sales	
Customer Type	**Electric**	**Gas**
Commercial	57%	36%
Residential	33%	60%
Industrial	10%	4%
Total	**100%**	**100%**

While our customer base has remained steady, gas and electric load have declined as illustrated:

Electric and Gas Distribution Statistics

	December 31, 2012		
	Number of Customers	**Electric Sales and Gas Sold and Transported**	**Historical Annual Load Decline 2008-2012**
Electric	2.2 Million	41,641 GWh	(1.4)%
Gas	1.8 Million	3,397 Million Therms	(0.6)%

The decline in both electric and gas sales were impacted by the unfavorable winter weather experienced in 2012 and customer conservation as a result of the economy. The first six months of 2012 were the warmest first half of a year on record in the United States. Electric sales were also impacted by a decline in the Industrial sector.

Solar Generation

We have undertaken major initiatives in order to spur investment in solar power in New Jersey. For additional details, please refer to our discussion under Energy Policy.

Supply

Although commodity revenues make up almost 48% of our revenues, we make no margin on the supply of energy since the actual costs are passed through to our customers.

All electric and gas customers in New Jersey have the ability to choose their own electric energy and/or gas supplier. Pursuant to the BPU requirements, we serve as the supplier of last resort for electric and gas customers within our service territory that are not served by another supplier. As a practical matter, this means we are obligated to provide supply to a vast majority of residential customers and a smaller portion of commercial and industrial customers.

We procure the supply to meet our BGS obligations through auctions authorized by the BPU for New Jersey's total BGS requirement. These auctions take place annually in February. Results of these auctions determine which energy suppliers are authorized to supply BGS to New Jersey's EDCs. Once validated by the BPU, electricity prices for BGS service are set.

PSE&G procures the supply requirements of our default service BGSS gas customers through a full requirements contract with Power. The BPU has approved a mechanism designed to recover all gas commodity costs related to BGSS for residential customers. BGSS filings are made annually by June 1 of each year, with an effective date of October 1. Any difference between rates charged under the BGSS contract and rates charged to our residential customers is deferred and collected or refunded through adjustments in future rates. Commercial and industrial customers that do not have third party suppliers are also supplied under the BGSS arrangement. These customers are charged a market-based price largely determined by prices for commodity futures contracts.

Markets and Market Pricing

Historically, there has been significant volatility in commodity prices. Such volatility can have a considerable impact on us since a rising commodity price environment results in higher delivered electric and gas rates for customers. This could result in decreased demand for electricity and gas, increased regulatory pressures and greater working capital requirements as the collection of higher commodity costs from our customers may be deferred under our regulated rate structure. A declining commodity price on the other hand, would be expected to have the opposite effect. For additional information, including the impact of natural gas commodity prices on electricity prices such as BGS, see Item 7. MD&A—Overview of 2012 and Future Outlook.

Energy Holdings

Energy Holdings primarily owns and manages a portfolio of lease investments and solar generation projects and is exploring opportunities for additional investment in renewable generation.

Over the past several years, we have terminated all of our international leveraged leases in order to reduce the cash tax exposure related to these leases. We have also reduced our risk by opportunistically monetizing all of our previous international investments. In February, 2012, the California Public Utilities Commission approved the shutdown of GWF Power and we anticipate recovering the remaining book value of our investment. For additional information on these generation facilities, see Item 2. Properties.

Products and Services

The majority of our remaining $840 million of domestic lease investments are primarily energy-related leveraged leases. As of December 31, 2012, 67% of our total leveraged lease investments were rated as below investment grade by Standard & Poor's.

Our leveraged leasing portfolio is designed to provide a fixed rate of return. Leveraged lease investments involve three parties: an owner/lessor, a creditor and a lessee. In a typical leveraged lease financing, the lessor purchases an asset to be leased. The purchase price is typically financed 80% with debt provided by the creditor and the balance comes from equity funds provided by the lessor. The creditor provides long-term financing to the transaction secured by the property subject to the lease. Such long-term financing is non-recourse to the lessor and, with respect to our lease investments, is not presented on our Consolidated Balance Sheets.

The lessor acquires economic and tax ownership of the asset and then leases it to the lessee for a period of time no greater than 80% of its remaining useful life. As the owner, the lessor is entitled to depreciate the asset under applicable federal and state tax guidelines. The lessor receives income from lease payments made by the lessee during the term of the lease and from tax benefits associated with interest and depreciation deductions with respect to the leased property. Our ability to realize these tax benefits is dependent on operating gains generated by our other operating subsidiaries and allocated pursuant to the consolidated tax sharing agreement between us and our operating subsidiaries.

Lease rental payments are unconditional obligations of the lessee and are set at levels at least sufficient to service the non-recourse lease debt. The lessor is also entitled to any residual value associated with the leased asset at the end of the lease term. An evaluation of the after-tax cash flows to the lessor determines the return on the investment. Under accounting principles generally accepted in the United States (GAAP), the leveraged lease investment is recorded net of non-recourse debt and income is recognized as a constant return on the net unrecovered investment.

For additional information on leases, including the credit, tax and accounting risks, see Item 1A. Risk Factors, Item 7A. Quantitative and Qualitative Disclosures About Market Risk—Credit Risk, Item 8. Financial Statements and Supplementary Data—Note 8. Financing Receivables and Note 13. Commitments and Contingent Liabilities.

Through Energy Holdings, we own and operate solar projects in New Jersey, Delaware, Florida, Ohio and Arizona totaling 69 MW. See Item 2. Properties for additional information.

In January 2012, we acquired a 25 MW solar project in Arizona. This project is currently in service. All of the energy, capacity and environmental attributes generated by the project in the first 20 years are expected to be sold under a long-term power purchase agreement. The total investment for the project was approximately $75 million.

In September 2012, we acquired a 15 MW solar project in Delaware. This project is currently in service. The project has a 20-year power purchase agreement for energy and the majority of renewable energy credits with a wholesale electric utility servicing municipal EDCs in Delaware. Energy Holdings has issued guarantees of up to $37 million for payment of obligations related to the construction of the project, of which $4 million was outstanding as of December 31, 2012. The total investment for the project was approximately $47 million.

In December 2012, we acquired an additional 19 MW solar project currently under construction in Arizona. The project is expected to begin commercial operation in the latter half of 2013. Energy Holdings has issued guarantees of up to $48 million for payment of obligations related to the construction of the project, all of which were outstanding as of December 31, 2012. The total investment for the project is expected to be approximately $51 million.

Also, in December 2011, the Long Island Power Authority (LIPA) selected PSEG Long Island LLC (PSEG LI), a newly formed wholly owned subsidiary of Energy Holdings, to manage its electric transmission and distribution system in Long Island, New York. LIPA issued a press release that it had selected us for a variety of reasons, including our proven track record of first quartile customer service and reliability, commitment to cost control, corporate culture of transparency and local decision making, technical expertise and proven environmental track record. The ten-year contract, Operations Services Agreement (OSA), is scheduled to commence on January 1, 2014, following completion of the Transition Services Agreement (TSA). As part of the OSA, PSEG LI will be expected to develop and manage the implementation of a number of operational improvements to provide safe and reliable service for LIPA's customers, increase customer satisfaction and manage the operational and maintenance costs of LIPA. In November, 2012, the Governor of New York initiated an inquiry into the current structure of LIPA as a political subdivision of the State Of New York. The privatization of LIPA's transmission and distribution system is among the restructuring options under consideration. LIPA has the right under the OSA and the TSA to terminate each agreement, in the event that LIPA elects to either transfer its transmission and distribution system to a third party (privatization) or operate and maintain its transmission and distribution system with its own employees (municipalization). If LIPA elects to implement either of these options, LIPA is required to pay PSEG LI its service fees, milestone payments and wind-down expenses, in each case up to the effective date of such termination.

COMPETITIVE ENVIRONMENT

Power

Various market participants compete with us and one another in buying and selling in the wholesale energy markets, entering into bilateral contracts and selling to aggregated retail customers. Our competitors include:

- merchant generators,
- domestic and multi-national utility generators,
- energy marketers,
- banks, funds and other financial entities,
- fuel supply companies, and
- affiliates of other industrial companies.

New additions of lower-cost or more efficient generation capacity could make our plants less economical in the future. Although it is not clear if this capacity will be built or, if so, what the economic impact will be, such additions could impact market prices and our competitiveness.

Our business is also under competitive pressure due to demand side management (DSM) and other efficiency efforts aimed at changing the quantity and patterns of usage by consumers which could result in a reduction in load requirements. A reduction in load requirements can also be caused by economic cycles, weather, customer migration and other factors. It is also possible that advances in technology, such as distributed generation, will reduce the cost of alternative methods of producing electricity to a level that is competitive with that of most central station electric production. To the extent that additions to the transmission system relieve or reduce congestion in eastern PJM where most of our plants are located, our revenues could be adversely affected. Changes in the rules governing what types of transmission will be built, who is permitted to build transmission and who will pay the costs of future transmission could also impact our revenues.

We are also at risk if the states in which we operate take actions that interfere with competitive wholesale markets. For example, on January 28, 2011, New Jersey enacted a law establishing a long-term capacity agreement pilot program (LCAPP) which provides for up to 2,000 MW of subsidized base load or mid-merit electric power generation. This action may have the effect of artificially depressing prices in the competitive wholesale market and thus has the potential to harm competitive markets, on both a short-term and a long-term basis.

Environmental issues, such as restrictions on emissions of carbon dioxide (CO_2) and other pollutants, may also have a competitive impact on us to the extent that it becomes more expensive for some of our plants to remain compliant, thus affecting our ability to be a lower-cost provider compared to competitors without such restrictions. In addition, most of our plants, which are located in the Northeast where rules are more stringent, can be at an economic disadvantage compared to our competitors in certain Midwest states. If any new legislation were to require our competitors to meet the environmental standards currently imposed upon us, we would likely have an economic advantage since we have already installed significant pollution-control technology at most of our fossil stations.

In addition, pressures from renewable resources could increase over time. For example, many parts of the country, including the mid-western region within the footprint of the Midwest Independent System Operator, the California ISO and the PJM region, have either implemented or proposed implementing changes to their respective regional transmission planning processes that may enable the construction of large amounts of “public policy” transmission to move renewable generation to load centers. For additional information, see the discussion in Regulatory Issues—Federal Regulation, below.

PSE&G

Our transmission and distribution business is minimally impacted when customers choose alternate electric or gas suppliers since we earn our return by providing transmission and distribution service, not by supplying the commodity. The demand for electric energy and gas by customers is affected by customer conservation, economic conditions, weather and other factors not within our control.

Changes in the current policies for building new transmission lines, such as those ordered by the FERC and being implemented by PJM and other ISOs to eliminate contractual provisions that provide us a “right of first refusal” to construct projects in our service territory, could result in additional competition to build transmission lines in our area in the future and would allow us to seek opportunities to build in other service territories.

Construction of new local generation, such as the proposed subsidized generation in New Jersey and Maryland, also has the potential to reduce the need for the construction of new transmission to transport remote generation and alleviate system constraints.

EMPLOYEE RELATIONS

As of December 31, 2012, we had 9,798 employees within our subsidiaries, including 6,248 covered under collective bargaining agreements. During the fourth quarter of 2012, we reached agreements with four labor unions to extend their collective bargaining agreements for four years. Three of these agreements expire in April 2017 and one expires in October 2017. Collectively, these four unions represent approximately 80% of union employees of PSE&G, Power and Services. Our collective bargaining agreements with our other two unions are set to expire in April and May 2014, respectively. We believe we maintain satisfactory relationships with our employees.

Employees as of December 31, 2012	Power	PSE&G	Energy Holdings	Services
Non-Union	1,172	1,398	15	965
Union	1,442	4,797	—	9
Total Employees	**2,614**	**6,195**	**15**	**974**
Number of Union Groups	3	5	—	1

REGULATORY ISSUES

Federal Regulation

FERC

The FERC is an independent federal agency that regulates the transmission of electric energy and gas in interstate commerce and the sale of electric energy and gas at wholesale pursuant to the Federal Power Act (FPA) and the Natural Gas Act. PSE&G and the generation and energy trading subsidiaries of Power are public utilities as defined by the FPA. The FERC has extensive oversight over such "public utilities." FERC approval is usually required when a public utility seeks to: sell or acquire an asset that is regulated by the FERC (such as a transmission line or a generating station); collect costs from customers associated with a new transmission facility; charge a rate for wholesale sales under a contract or tariff; or engage in certain mergers and internal corporate reorganizations.

The FERC also regulates generating facilities known as qualifying facilities (QFs). QFs are cogeneration facilities that produce electricity and another form of useful thermal energy, or small power production facilities where the primary energy source is renewable, biomass, waste or geothermal resources. QFs must meet certain criteria established by the FERC. We own various QFs through Energy Holdings. QFs are subject to some, but not all, of the same FERC requirements as public utilities.

The FERC also regulates Regional Transmission Operators/ISOs, such as PJM, and their energy and capacity markets.

For us, the major effects of the FERC regulation fall into five general categories:

- Regulation of Wholesale Sales—Generation/Market Issues
- Energy Clearing Prices
- Capacity Market Issues
- Transmission Regulation
- Compliance

Regulation of Wholesale Sales—Generation/Market Issues

Market Power

Under FERC regulations, public utilities must receive FERC authorization to sell power in interstate commerce. They can sell power at cost-based rates or apply to the FERC for authority to make market based rate (MBR) sales. For a requesting company to receive MBR authority, the FERC must first make a determination that the requesting company lacks market power in the relevant markets and/or that market power in the relevant markets is sufficiently mitigated. The FERC requires that holders of MBR tariffs file an update every three years demonstrating that they continue to lack market power and/or that market power has been sufficiently mitigated and report in the interim to FERC any material change in facts from those the FERC relied on in granting MBR authority.

PSE&G, PSEG Energy Resources & Trade LLC, PSEG Power Connecticut, PSEG Fossil LLC and PSEG Nuclear LLC were each granted continued MBR authority from the FERC in June 2011. PSEG New Haven LLC was also granted initial MBR authority in May 2012. Retention of MBR authority is important to the maintenance of our current generation business' revenues.

Energy Clearing Prices

Energy clearing prices in the markets in which we operate are generally based on bids submitted by generating units. Under FERC-approved market rules, bids are subject to price caps and mitigation rules applicable to certain generation units. The FERC rules also govern the overall design of these markets. At present, all units receive a single clearing price based on the bid of the marginal unit (i.e. the last unit that must be dispatched to serve the needs of load). These FERC rules have a direct impact on the energy prices received by our units.

Capacity Market Issues

PJM, NYISO, and ISO-NE each have capacity markets that have been approved by FERC.

PJM—RPM is a locational installed capacity market design for the PJM region, including a forward auction for installed capacity. Under RPM, generators located in constrained areas within PJM are paid more for their capacity as an incentive to ensure adequate supply where generation capacity is most needed. The mechanics of RPM in PJM continue to evolve and be refined in stakeholder proceedings in which we are active, and there is currently significant discussion about the future role of demand response in the RPM market, including examining how demand response resources should be paid and how these resources and programs should be measured and verified to ensure their availability.

ISO-NE—ISO-NE's market for installed capacity with all generators in New England provides fixed capacity payments. The market design consists of a forward-looking auction for installed capacity that is intended to recognize the locational value of generators on the system and contains incentive mechanisms to encourage generator availability during generation shortages. As in PJM, capacity market rules in ISO-NE continue to develop. We challenged in court the results of ISO-NE's first forward capacity auction, arguing that our units received inadequate compensation notwithstanding the location of our resources in a constrained area. The D.C. Circuit Court of Appeals ruled in our favor and remanded the proceeding to the FERC where it remains pending. We and other generators also filed a complaint at the FERC regarding ISO-NE's capacity market design, alleging that it insufficiently reflects locational capacity values. The FERC acted on the complaint, largely accepting the ISO-NE's capacity market design; however, an appeal of this rule is pending.

NYISO—NYISO operates a short-term capacity market that provides a forward price signal only for six months into the future. The NYISO capacity model recognizes only two separate zones that potentially may separate in price: New York City and Long Island. NYISO is creating a third locality encompassing the lower Hudson Valley to take effect May 1, 2014. The exact configuration of this new zone has not yet been determined. The triennial process for updating demand curves used for establishing capacity prices is also underway. The NYISO is required to file with the FERC by the end of 2013 revised demand curves covering the May 1, 2014 through April 30, 2017 period. Discussions concerning other potential changes to NYISO capacity markets, including rules to govern payments and bidding requirements for generators proposing to exit the market but required to remain in service for reliability reasons, are also ongoing.

Long-Term Capacity Agreement Pilot Program Act (LCAPP)—In 2011, the State of New Jersey concluded that new natural gas-fired generation was needed and enacted the LCAPP Act to subsidize approximately 2,000 MW of new generation. The LCAPP Act provided that subsidies would be offered through long-term standard offer capacity agreements (SOCAs) between selected generators and the New Jersey Electric Distribution Companies (EDCs). The SOCA required each New Jersey EDC to provide the generators with guaranteed capacity payments funded by ratepayers. Each of the New Jersey EDCs, including PSE&G, entered into the SOCAs as directed by the State, but did so under protest reserving their rights. In May 2012, two of the three generators, CPV Shore, LLC (CPV), a subsidiary of Competitive Power Ventures, Inc. and Hess Newark, LLC (Hess), a subsidiary of Hess Corporation, that received SOCA contracts cleared the RPM auction for the 2015/2016 delivery year in the aggregate notional amount of approximately 1,300 MW of installed capacity.

Legal challenges to the BPU's implementation of the LCAPP Act were filed in New Jersey appellate court and the appeal remains pending. In addition, the LCAPP Act has been challenged on constitutional grounds in federal court. The hearing for this matter is scheduled to begin in March 2013.

Maryland is also taking action to subsidize above-market new generation. In April 2012, the Maryland Public Service Commission (PSC) issued an order requiring the Maryland utility companies to enter into a contract with CPV Shore, LLC (CPV) to build a new 661 MW natural gas-fired, combined cycle station in Maryland with an in-service date of June 2015. This contract has not yet been finalized, as the Maryland PSC continues to evaluate its terms. In the May 2012 RPM auction, the CPV generator cleared the auction. We have joined other generators in challenging this order on constitutional grounds in federal court and that case is set for hearing in March 2013. The Maryland EDCs have also appealed the April 2012 order in state court.

These efforts to artificially depress prices in the wholesale capacity auction were intended to be mitigated by the Minimum Offer Price Rule (MOPR) approved by the FERC. The MOPR was intended to restrict new generation from bidding in RPM at less than an established minimum level established by Tariff, or a cost-based bid to the extent that the generator can demonstrate that its costs are lower than the MOPR. The MOPR was in place for the May 2012 auction, but we believe it did not operate to protect the market against these suppression efforts given that two of the three SOCA generators cleared the auction. As a result, discussions among a diverse group of PJM stakeholders to improve the MOPR ensued and a settlement was reached among those stakeholders. That proposal was then subject to a PJM stakeholder review and vote. The proposal was modified and received almost a 90% supporting vote. In December 2012, PJM filed Tariff changes with the FERC to implement the revised MOPR. In February 2013, the FERC issued a deficiency letter to PJM seeking additional information regarding the proposed MOPR changes. PJM must respond to those changes within 30 days and then the FERC has 60 days to act on the proposal. If FERC approves the proposal, we believe these modifications should significantly improve the MOPR rules and appropriately reduce the ability for subsidized generation assets to artificially suppress wholesale market prices. We cannot predict the outcome of this matter.

Transmission Regulation

The FERC has exclusive jurisdiction to establish the rates and terms and conditions of service for interstate transmission. We currently have FERC-approved formula rates in effect to recover the costs of our transmission facilities. Under this formula, rates are put into effect in January of each year based upon our internal forecast of annual expenses and capital expenditures. Rates are then trued up the following year to reflect actual annual expenses/capital expenditures. Our allowed ROE is 11.68% for both existing and new transmission investments and we have received incentive rates, affording a higher ROE, for certain large scale transmission investments. Our 2012 Annual Formula Rate Update with the FERC provided for approximately $94 million in increased annual transmission revenues effective January 1, 2012. We filed our 2013 Annual Formula Rate Update with the FERC in October 2012, which provides for approximately $174 million in increased annual transmission revenues effective January 1, 2013.

- ***Transmission Policy Developments***—In 2010, the FERC initiated a proceeding to evaluate whether reforms to current transmission planning and cost allocation rules were necessary to stimulate additional transmission development. The rulemaking also addressed the issue of whether construction of transmission should be opened up to competition by eliminating the “right of first refusal” (ROFR) under which incumbent transmission companies such as PSE&G have a ROFR to build transmission located within their respective service territories. The FERC ultimately concluded in Order No. 1000 that the ROFR should be eliminated, subject to certain exceptions, and left it to Regional Transmission Organizations/Independent System Operators such as PJM to establish the implementation details. We, along with many other companies, have challenged the FERC's orders in federal court. In addition, we have joined other PJM transmission owners in filing for the FERC approval of new rules that will determine who pays for future transmission projects in PJM.

  We cannot predict the final outcome or impact on us; however, specific implementation of Order 1000 in the various regions, including within our service territory, may expose us to competition for certain types of transmission projects, while at the same time providing opportunities to build transmission outside of our service territory.

- ***Transmission Expansion***—In June 2007, PJM identified the need for the construction of the Susquehanna-Roseland line, a new 500 kiloVolt (kV) transmission line intended to maintain the reliability of the electrical grid serving New Jersey customers. PJM assigned construction responsibility for the new line to us and PPL Corporation (PPL) for the New Jersey and Pennsylvania portions of the project, respectively. The estimated cost of our portion of this construction project is up to $790 million, and PJM had originally directed that the line be placed into service by June 2012. As of December 31, 2012, total capital expenditures were $324 million. Construction of the Susquehanna-Roseland line is contingent upon obtaining all necessary federal, state, municipal and landowner permits and approvals. We have obtained environmental permits for the project from the New Jersey Department of Environmental Protection (NJDEP). On October 1, 2012, the National Park Service (NPS) issued a final Environmental Impact Statement (EIS) for the Susquehanna-Roseland line, selecting our and PPL's choice of route in certain federal park lands subject to the NPS' jurisdiction that follows the existing right of way. On October 15, 2012, several environmental groups filed a complaint in federal court, which, as amended, challenges the NPS' issuance of the final EIS, seeking to set aside the EIS and asking the court for an injunction that would generally prohibit construction of the project within the federal park lands at issue. If this request for injunctive relief is granted, the construction schedule for the project could be impacted. We have begun construction in those areas where necessary permits have been obtained. Currently, the expected in-service date for the Eastern segment of the project is June 2014 and for the Western segment is June 2015, although further delays are possible. Delays in the construction schedule could impact the cost of construction and the timing of expected transmission revenues.

  Also, in 2010, certain environmental groups had appealed the BPU's approval of the Susquehanna-Roseland line, although no stay was sought. On February 11, 2013, the Appellate Division of the New Jersey Superior Court issued an order rejecting the appeal and affirming the BPU's approval of the project.

We had previously been directed by PJM to build a 500 kV reliability project from Branchburg to Roseland to Hudson. The scope of this project has since changed; it is now a 230 kV project referred to as the Northeast Grid project, for which we are currently seeking to obtain municipal siting approvals. The Northeast Grid project has an expected in-service date of June 2015 and an estimated cost of construction of $895 million. As of December 31, 2012, total capital expenditures were $88 million.

In 2012, both the BPU and the NJDEP approved siting of the North Central Reliability project. This project, which involves upgrading certain circuits and switching stations from 138 kV to 230 kV in the northern and central portions of New Jersey, is estimated to cost up to $390 million and has an in-service date of June 2014. The project is currently under construction and, as of December 31, 2012, total capital expenditures for this project were $163 million.

In 2012, we received both municipal siting and the NJDEP approval for the Burlington-Camden project. The project, which also involves upgrading certain circuits and switching stations from 138 kV to 230 kV in the southern portion of New Jersey, is estimated to cost up to $399 million and has an in-service date of June 2014. The project is currently under construction. As of December 31, 2012, total capital expenditures for the project were $169 million.

We are still in the process of obtaining necessary municipal and environmental approvals for the Mickleton-Gloucester-Camden project. This is another project that involves converting both circuits and switching stations from 138 kV to 230 kV in southern New Jersey and is estimated to cost up to $435 million. The project has an in-service date of June 2015. This project is still in the engineering/design phase and, as of December 31, 2012, total capital expenditures were $24 million.

- ***Transmission Rate Proceedings***—In September 2011, the Massachusetts Attorney General, along with several state utility commissions, consumer advocates and consumer groups from six New England states, filed a complaint at the FERC against a group of New England transmission owners seeking to reduce the base return on equity used in calculating these transmission owners' formula transmission rates. The matter has been set for hearing, and the proceeding is pending. In addition, there have been FERC complaints filed by municipal utilities in New York against a New York transmission-owning utility seeking to lower that utility's transmission ROE. While we are not the subject of any of these complaints. The results of these proceedings could set a precedent for the FERC-regulated transmission owners with formula rates in place, such as ours.

Compliance

- ***FERC Audit***—Each of the PSEG companies that have MBR authority from the FERC is being audited by the FERC for compliance with its rules for (i) receiving and retaining MBR authority (ii) the filing of electric quarterly reports and (iii) our units' receipt of payments from the RTO/ISO when they are required to run for reliability reasons when it is not economic for them to do so. The FERC will issue a report at the conclusion of the audit.
- ***Reliability Standards*****—**Congress has required the FERC to put in place, through the North American Electric Reliability Council (NERC), national and regional reliability standards to ensure the reliability of the United States electric transmission and generation system and to prevent major system blackouts. Many reliability standards have been developed and approved. These standards apply both to reliability of physical assets interconnected to the bulk power system and to the protection of critical cyber assets. Our generation assets were audited in 2011 and our utility assets were audited in 2012. NERC compliance represents a significant and challenging area of compliance responsibility for us. As new standards are developed and approved, existing standards are revised and registration requirements are modified which could increase our compliance responsibilities.

Commodity Futures Trading Commission (CFTC)

In accordance with the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), the SEC and the CFTC are in the process of implementing a new regulatory framework for swaps and security-based swaps. The legislation was enacted to reduce systemic risk, increase transparency and promote market integrity within the financial system by providing for the registration and comprehensive regulation of swap dealers and by imposing recordkeeping, data reporting, margin and clearing requirements with respect to swaps. To implement the Dodd-Frank Act, the CFTC has engaged in a comprehensive rulemaking process and has issued a number of proposed and final rules addressing many of the key issues. For example, the CFTC has issued rules defining the term “swap dealer” and “commercial end user” (We fall in the latter category). The CFTC also issued rules establishing position limits for trading in certain commodities, such as natural gas but a federal court vacated these rules. The CFTC has appealed this decision to vacate the position limits rules. We are currently preparing to comply with the new record keeping and data reporting requirements of the Dodd-Frank Act applicable to commercial end users, for compliance in April 2013. We are continuing to analyze the potential impact of these rules and preparing to comply with the requirements that apply to entities that are considered commercial end-users under the Dodd-Frank Act.

Nuclear Regulatory Commission (NRC)

Our operation of nuclear generating facilities is subject to comprehensive regulation by the NRC, a federal agency established to regulate nuclear activities to ensure protection of public health and safety, as well as the security and protection of the environment. Such regulation involves testing, evaluation and modification of all aspects of plant operation in light of NRC safety and environmental requirements. Continuous demonstration to the NRC that plant operations meet requirements is also necessary. The NRC has the ultimate authority to determine whether any nuclear generating unit may operate. The current operating licenses of our nuclear facilities expire in the years shown below:

Unit	Year
Salem Unit 1	2036
Salem Unit 2	2040
Hope Creek	2046
Peach Bottom Unit 2	2033
Peach Bottom Unit 3	2034

In 2010, we also filed an application for an Early Site Permit (ESP) for a new nuclear generating station to be located at the current site of the Salem and Hope Creek generating stations. The NRC acceptance review is complete and agency evaluation is underway. There were no petitions filed for permission to intervene. The current NRC schedule would likely result in a decision with respect to the issuance of the ESP in 2015. While the ESP qualifies the site as an approved location for a new reactor for a period of 20 years, it imposes no obligation to do so.

As a result of events at the Fukushima Daiichi nuclear facility in Japan following the earthquake and tsunami in March 2011, the NRC began performing additional operational and safety reviews of nuclear facilities in the United States. These reviews and the lessons learned from the events in Japan have resulted in additional regulation for the nuclear industry and could impact future operations and capital requirements for our facilities. We believe that our nuclear plants currently meet the stringent applicable design and safety specifications of the NRC.

In 2011, the NRC task force submitted a report containing various recommendations to ensure plant protection, enhance accident mitigation, strengthen emergency preparedness and improve NRC program efficiency. The NRC staff also issued a document which provided for a prioritization of the task force recommendations. The NRC approved the staff's prioritization and implementation recommendations subject to a number of conditions. Among other things, the NRC advised the staff to give the highest priority to those activities that can achieve the greatest safety benefit and/or have the broadest applicability (Tier 1), to review filtration of boiling water reactor (BWR) primary containment vents and encouraged the staff to create requirements based on a performance-based system which allows for flexible approaches and the ability to address a diverse range of site-specific circumstances and conditions and strive to implement the requirements by 2016. The NRC issued letters and orders to licensees implementing the Tier 1 recommendations in March 2012. Additional regulations are expected.

Separately, a petition was filed with the NRC in April 2011 seeking suspension of the operating licenses of all General Electric BWRs utilizing the Mark I containment design in the United States, including our Hope Creek and Peach Bottom units, pending completion of the NRC review. Fukushima Daiichi Units 1-4 are BWRs equipped with Mark I containments. The petition names 23 of the total 104 active commercial nuclear reactors in the United States. While we do not believe the petition will be successful, we are unable to predict the outcome of any action that the NRC may take in connection with the petition

State Regulation

Since our operations are primarily located within New Jersey, our principal state regulator is the BPU, which oversees electric and natural gas distribution companies in New Jersey. Our utility operations are subject to comprehensive regulation by the BPU including, among other matters, regulation of retail electric and gas distribution rates and service, the issuance and sale of certain types of securities and compliance matters. PSE&G's participation in solar, demand response and energy efficiency programs is also regulated by the BPU, as the terms and conditions of these programs are approved by the BPU. BPU regulation can also have a direct or indirect impact on our power generation business as it relates to energy supply agreements and energy policy in New Jersey.

We are also subject to various other states’ regulations due to our operations in those states.

Rates

- ***Electric and Gas Base Rates***—We must file electric and gas rate cases with the BPU in order to change our utility base distribution rates. Our last base rate adjustment was in 2010.

- ***Rate Adjustment Clauses and Other Regulatory Filings***—In addition to base rates, we recover certain costs or earn on certain investments, from customers pursuant to mechanisms known as adjustment clauses. These clauses permit, at set intervals, the flow-through of costs to, or the recovery of investments from, customers related to specific programs, outside the context of base rate case proceedings. Recovery of these costs or investments is subject to BPU approval for which we make periodic filings. Delays in the pass-through of costs or recovery of investments under these mechanisms could result in significant changes in cash flow. For additional information on our specific filings, see Item 8. Financial Statements and Supplementary Data—Note 6. Regulatory Assets and Liabilities.

  Some of our more significant recovery mechanisms and filings are as follows:
- ***Storm Damage Deferral***—In December 2012, the BPU granted our request to defer on our books actually incurred, uninsured, incremental storm restoration costs to our gas and electric distribution systems associated with extraordinary storms, including Hurricane Irene and Superstorm Sandy. In February 2013, the BPU announced that it would initiate a generic proceeding to evaluate the prudency of extraordinary, storm-related costs incurred by all of the regulated utilities as a result of the natural disasters experienced in New Jersey in 2011 and 2012 and in this proceeding will consider the manner in which such prudent costs shall be recovered.
- ***Capital Infrastructure Programs (CIP I and CIP II)***—We have received approval from the BPU for programs that provide for accelerated investment in utility infrastructure. The goal of these accelerated capital investments is to improve the reliability of our utility's infrastructure and New Jersey's economy through job creation. The programs allow us to receive a full return of and on our investments. In December 2012, the BPU approved stipulations regarding our CIP I and CIP II filings effective January 1, 2013. These Orders resulted in a combined increase of $40 million and $23 million for electric and gas customers, respectively.
- ***Weather Normalization Clause (WNC)***—Our WNC is an annual rate mechanism that allows us to increase our rates to compensate for lower revenues we receive from customers as a result of warmer-than-normal winters and to decrease our rates to make up for higher revenues we receive as a result of colder-than-normal winters. The payments and refunds are subject to certain limitations and rate caps. Unrecovered balances associated with application of the rate cap are deferred until the next recovery period. This rate mechanism requires us to calculate, at the end of each October-to-May period, the level by which margin revenues differed from what would have resulted if normal weather had occurred. In June 2012, we filed a petition and testimony with the BPU including eight months of actual and four months of forecasted data, which sought BPU approval to recover $41 million in deficiency revenues from our customers during the 2012-2013 Winter Period (October 1 to May 31) and a carryover deficiency of $16 million to the 2013-2014 Winter Period. In September 2012, an Order approving the stipulation for provisional rates was signed. In December 2012, we made a supplemental filing incorporating twelve months of actual financial data, which would, if approved by the BPU, result in no change to customer rates during the 2012-2013 Winter Period. The supplemental filing would, however, result in an increase of the carryover deficiency to the 2013-2014 Winter Period from $16 million to $24 million. We are awaiting a final Order.
- ***Solar and Energy Efficiency Recovery Charges (RRC)*** —are comprised of: Carbon Abatement, Energy Efficiency Economic Stimulus Program (EEE), EEE Extension, Demand Response, Solar 4 All, and Solar Loan II. These programs are aimed at reducing the New Jersey's Greenhouse Gas (GHG) Emissions. We file for annual recovery for our investments under these programs which includes a return on our investment and recovery of expenses. In July 2012, we filed a petition with the BPU requesting an increase in RRC seeking to recover approximately $62 million in electric revenue and $8 million in gas revenue, on an annual basis consistent with the terms of the approved program. The discovery phase of this proceeding is underway.

Other material rate filings pending before the BPU include:

Energy Strong (ES) Program—In February 2013, we filed a petition with the BPU describing the improvements we recommend making to our BPU jurisdictional electric and gas system to harden and improve resiliency for the future. The changes that were described would be made over a ten year period. In this petition, we are seeking approval to invest $0.9 billion in our gas distribution system and $1.7 billion in our electric distribution system over an initial five year period, plus associated expenses, and to receive contemporaneous recovery of and on such investments. The current estimated cost of the entire program, including the first five years of investments for which we sought approval in this petition, is $3.9 billion. We anticipate seeking BPU approval to complete our investment under the program at a later date. For additional information, see Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations—Capital Requirements.

Solar 4 All Extension—In July 2012, we filed for an extension of our Solar 4 All program. In this filing, we are seeking BPU approval to invest up to $690 million to develop 136 MW of utility-owned solar photovoltaic systems over a five year period starting in 2013. Consistent with the existing Solar 4 All program, we propose to sell the energy and capacity from the solar systems in the PJM wholesale energy and capacity markets which will offset the cost of the program.

We also filed for an additional extension of our Solar Loan program (Solar Loan III) in July 2012. In the filing, we are seeking BPU approval to provide financing support for the installation of 97.5 MW of solar systems by providing loans to qualified customers. The total investment of the proposed Solar Loan III program is anticipated to be up to $193 million once the program is fully subscribed, the projects are built and the loans are closed.

Energy Supply

BGS—New Jersey's EDCs provide two types of BGS, the default electric supply service for customers who do not have a third party supplier. The first type, which represents about 80% of PSE&G's load requirements, provides default supply service for smaller industrial and commercial customers and residential customers at seasonally-adjusted fixed prices for a three-year term (BGS-Fixed Price). These rates change annually on June 1 and are based on the average price obtained at auctions in the current year and two prior years. The second type provides default supply for larger customers, with energy priced at hourly PJM real-time market prices for a contract term of 12 months (BGS-CIEP).

All of New Jersey's EDCs jointly procure the supply to meet their BGS obligations through two concurrent auctions authorized each year by the BPU for New Jersey's total BGS requirement. These auctions take place annually in February. Results of these auctions determine which energy suppliers provide BGS to New Jersey's EDCs.

Approximately one-third of PSE&G's total BGS-Fixed Price eligible load is auctioned each year for a three-year term. Current pricing is as follows:

	2010	2011	2012	2013	
36 Month Terms Ending	May 2013	May 2014	May 2015	May 2016	(A)
Eligible Load (MW)	2,800	2,800	2,900	2,800	
$ per kWh	0.09577	0.09430	0.08388	0.09218	

(A) Prices set in the February 2013 BGS Auction will be effective on June 1, 2013 when the 2010 BGS agreements expire.

The BPU approved the auction process for 2013 with no significant changes to the process.

For additional information, see Item 8. Financial Statements and Supplementary Data— Note 13. Commitments and Contingent Liabilities.

BGSS—BGSS is the mechanism approved by the BPU designed to recover all gas costs related to the supply for residential customers. BGSS filings are made annually by June 1 of each year, with an effective date of October 1. PSE&G's revenues are matched with its costs using deferral accounting, with the goal of achieving a zero cumulative balance by September 30 of each year. In addition, we have the ability to put in place two self-implementing BGSS increases on December 1 and February 1 of up to 5% and also may reduce the BGSS rate at any time.

PSE&G had a full requirements contract with Power for an initial period which extended through March 2012 to meet the supply requirements of default service gas customers. This long-term contract continues on a year-to-year basis thereafter, unless terminated by either party with a one year notice. Power charges PSE&G for gas commodity costs which PSE&G recovers from customers. Any difference between rates charged by Power under the BGSS contract and rates charged to PSE&G's residential customers are deferred and collected or refunded through adjustments in future rates. PSE&G earns no margin on the provision of BGSS.

In June 2012, we made our annual BGSS filing with the BPU. The filing requested a decrease in annual BGSS revenue of $71 million, excluding sales and use tax, to be effective October 1, 2012. This represented a reduction of approximately 5.2% for a typical residential gas heating customer. This BGSS reduction was the ninth consecutive reduction since January 2009. We entered into a Stipulation with the parties which put the requested lower BGSS rate into effect as filed on October 1, 2012 on a provisional basis. A final decision is expected in early 2013.

Energy Policy

New Jersey Energy Master Plan (EMP)—New Jersey law requires that an EMP be developed every three years, the purpose of which is to ensure safe, secure and reasonably-priced energy supply, foster economic growth and development and protect the environment. The most recent EMP was finalized in December 2011.

The 2011 EMP places an emphasis on expanding in-state electricity resources and reducing energy costs. The plan also recognizes the impact of climate change and accepts the previously set goal of a 22.5% target for the renewable portfolio standard (RPS) in 2021. It also references a goal that 70% of New Jersey's energy supplies should be from clean energy sources by 2050. To meet this goal, the plan redefined clean energy to include nuclear, natural gas and hydro power along with defined renewable sources and proposes a number of changes aimed at reducing the cost of achieving the 22.5% goal.

Specific program initiatives in the EMP include:

- construction of new combined cycle natural gas plants through the implementation of LCAPP, with the continued State challenge to FERC and PJM policies on market pricing rules in the capacity market,
- support for construction of new nuclear generation,
- changes to the solar program to reduce cost, expand opportunities, expand transparency and ensure economic and environmental benefits,
- expanded natural gas use to meet energy needs,
- development of decentralized combined heat and power,
- redesign of the delivery of state energy efficiency programs, and
- continued support for implementation of off-shore wind, without setting a specific capacity goal.

Solar Initiatives—In order to spur investment in solar power in New Jersey and meet renewable energy goals, we have undertaken two major initiatives at PSE&G.

- **Solar Loans:** The first solar initiative helps finance the installation of 81 MW of solar systems throughout our electric service area by providing loans to customers. The borrowers can repay the loans over a period of either 10 years (for residential customer loans) or 15 years (for non-residential customers), by providing us with solar renewable energy certificates (SRECs) or cash. The value of the SRECs towards the repayment of the loan is guaranteed to be not less than a floor price. SRECs received by us in repayment of the loan are sold through a periodic auction. Proceeds are used to offset program costs.

  The total investment of both phases of the Solar Loan Program is expected to be between $210 million and $250 million once the program is fully subscribed, projects are built and loans are closed. As of December 31, 2012, we have provided a total of $209 million in loans for 878 projects representing 67 MW.

- **Solar 4 All:** The second solar initiative is the Solar 4 All Program under which we are investing approximately $456 million to develop 80 MW of utility-owned solar photovoltaic (PV) systems over four years. The program consists of centralized solar systems 500 kW or greater installed on PSE&G-owned property and third-party sites in our electric service territory (40 MW) and solar panels installed on distribution system poles (40 MW). We sell the energy and capacity from the systems in the PJM wholesale electricity market. In addition, we sell any SRECs received from the projects through the same auction used in the loan program. Proceeds from these sales are used to offset program costs.

  As of December 31, 2012, we have installed and placed in service 35 MW on approximately 160,000 distribution poles with an investment of approximately $245 million, and 39 MW of centralized solar systems representing 23 projects with an investment of approximately $192 million.

BPU Storm Report — In 2011, the BPU commenced an investigation of all four New Jersey electric utilities, including PSE&G, to examine their preparations, performance and restoration efforts during Hurricane Irene and the October 2011 snow storm. Following the completion of a report by its consultant, the BPU issued an order in January 2013, ordering the utilities to take specific action to improve their preparedness and responses to major storms. There are 103 separate measures contained in the Order, with most of the measures requiring utility implementation by September 2013. We are evaluating the implications of this report.

BPU Audits

Management/Affiliate Audit—In 2009, the BPU, in accordance with New Jersey statutes, initiated audits of PSE&G with respect to the effectiveness of its management and its compliance with rules governing PSE&G's interactions with its affiliated companies. In 2012, the BPU issued a report making a number of findings and recommendations, including the finding that no violations of either the state or federal affiliate rules were found. The BPU is expected to issue an order addressing the audit report's findings and recommendations, although timing is uncertain.

BPU Investigations

RRC/CIP—In January 2012, New Jersey's Rate Counsel requested that the BPU investigate certain allegations of wrong doing in PSE&G's solar, EEE, and CIP programs raised by three former employees in a lawsuit. The BPU initiated an inquiry into these allegations and requested documentation from PSE&G. PSE&G has cooperated with the BPU and provided all requested information and documentation.

ENVIRONMENTAL MATTERS

Changing environmental laws and regulations significantly impact the manner in which our operations are currently conducted and impose costs on us to reduce the health and environmental impacts of our operations. To the extent that environmental requirements are more stringent and compliance more costly in certain states where we operate compared to other states that are part of the same market, such rules may impact our ability to compete within that market. Due to evolving environmental regulations, it is difficult to project future costs of compliance and their impact on competition. Capital costs of complying with known pollution control requirements are included in our estimate of construction expenditures in Item 7. MD&A—Capital Requirements. The costs of compliance associated with any new requirements that may be imposed by future regulations are not known, but may be material.

Areas of environmental regulation may include, but are not limited to:

- air pollution control,
- climate change,
- water pollution control,
- hazardous substance liability, and
- fuel and waste disposal.

For additional information related to environmental matters, including proceedings not discussed below, as well as anticipated expenditures for installation of pollution control equipment, hazardous substance liabilities and fuel and waste disposal costs, see Item 1A. Risk Factors, Item 3. Legal Proceedings and Item 8. Financial Statements and Supplementary Data—Note 13. Commitments and Contingent Liabilities.

Air Pollution Control

Our facilities are subject to federal regulation under the Clean Air Act (CAA) which requires controls of emissions from sources of air pollution and imposes record keeping, reporting and permit requirements. Our facilities are also subject to requirements established under state and local air pollution laws.

The CAA requires all major sources, such as our generation facilities, to obtain and keep current an operating permit. The costs of compliance associated with any new requirements that may be imposed and included in these permits in the future could be material and are not included in our estimates of capital expenditures.

- ***New Jersey Nitrogen Oxide (NO_x) Regulation: High Electric Demand Day***—In April 2009, the New Jersey Department of Environmental Protection (NJDEP) finalized revisions to NO_x emission control regulations that impose new NO_x emission reduction requirements and limits for New Jersey fossil fuel-fired electric generation units. The rule has an impact on our generation fleet, as it imposes NO_x emissions limits that require capital investment for controls or the retirement of up to 86 combustion turbines (approximately 1,750 MW) and four older New Jersey steam electric generation units (approximately 400 MW) by May 2015. Retirement notifications for the combustion turbines, except for Salem Unit 3, have been filed with PJM. The Salem Unit 3 combustion turbine (38 MW) will be transitioning to an emergency generator. Evaluations are ongoing for the steam electric generation units.
- ***Connecticut NO_x Regulation***—Under current Connecticut regulations, our Bridgeport and New Haven facilities have been utilizing Discrete Emission Reduction Credits (DERCs) to comply with certain NOx emission limitations that

were incorporated into the facilities' operating permits. In 2010, we negotiated new agreements with the State of Connecticut extending the continued use of DERCs for certain emission units and equipment until May 31, 2014.

- ***Hazardous Air Pollutants Regulation***—In accordance with a ruling of the United States Court of Appeals of the District of Columbia (Court of Appeals), the EPA published a Maximum Achievable Control Technology (MACT) regulation on February 16, 2012. These Mercury Air Toxics Standards (MATS) are scheduled to go into effect on April 16, 2015 and establish allowable emission levels for mercury as well as other hazardous air pollutants pursuant to the CAA. In February 2012, members of the electric generating industry filed a petition challenging the existing source National Emission Standard for Hazardous Air Pollutants (NESHAP), new source NESHAP and the New Source Performance Standard (NSPS). In March 2012, PSEG filed a motion to intervene with the Court of Appeals in support of the EPA's implementation of MATS. The Court of Appeals has split the litigation related to these matters into three cases, addressing separately the existing source NESHAP, new source NESHAP and the NSPS. These cases remain pending. The EPA has stayed implementation of the new source NESHAP rule pending its reconsideration. The EPA published the proposed reconsideration for the new source NESHAP and the NSPS in the Federal Register on November 30, 2012. The EPA expects to finalize the reconsideration of the new source NESHAP and the NSPS in March 2013.

  The impact to our fossil generation fleet in New Jersey and Connecticut and our jointly-owned coal fired generating facilities in Pennsylvania is currently being determined. We believe the back-end technology environmental controls installed at our Hudson and Mercer coal facilities should meet the MACT's requirements. Some additional controls could be necessary at our Connecticut facility, pending engineering evaluation. In December 2011, a decision was reached to upgrade the previously planned two flue gas desulfurization scrubbers and install Selective Catalytic Reduction (SCR) systems at our jointly-owned coal fired generating facility at Conemaugh in Pennsylvania. This installation is expected to be completed in the fourth quarter of 2014. Our share of this investment is approximately $147 million.

- ***Cross-State Air Pollution Rule (CSAPR)***—On July 6, 2011, the EPA issued the final CSAPR. CSAPR limits power plant emissions of Sulfur Dioxide (SO_2) and annual and ozone season NO_x in 28 states that contribute to the ability of downwind states to attain and/or maintain current particulate matter and ozone National Ambient Air Quality Standards (NAAQS).

  On August 21, 2012, the Court of Appeals vacated CSAPR and ordered that the existing Clean Air Interstate Rule (CAIR) requirements remain in effect until an appropriate substitute rule has been promulgated. On October 5, 2012, the EPA filed a request for rehearing which the Court denied on January 24, 2013. What future actions the EPA will take regarding the Court's decision or the timing of those actions are unknown at this time. The purpose of CAIR is to improve ozone and fine particulate air quality within states that have not demonstrated achievement of the NAAQS. CAIR was implemented through a cap-and-trade program and, to date, the impact has not been material to us as the allowances allocated to our stations were sufficient. If 2013 operations are similar to those in the past three years, it is expected that the impact to operations in New Jersey, New York and Connecticut from the temporary implementation of CAIR in 2013 will not be significant.

  We currently anticipate that this rule will not have a material adverse impact to our capital investment program or our units' operations.

Climate Change

- ***CO_2 Regulation Under the* CAA**—In April 2010, the EPA and the National Highway Transportation Safety Board (NHTSB) jointly issued a final rule to regulate GHGs emissions from certain motor vehicles (Motor Vehicle Rule). Under the CAA, the adoption of the Motor Vehicle Rule would have automatically subjected many emission sources, including ours, to CAA permitting for new facilities and major facility modifications that increase the emission of GHGs, including CO_2. However, guidance issued by the EPA in March 2010 interpreted the CAA to require permitting for GHGs at other facilities, such as ours, only when the Motor Vehicle Rule was scheduled to take effect in January 2011. In May 2010, the EPA finalized a "Tailoring Rule" that would have phased in beginning in 2011, the application of this permitting requirement to facilities such as ours. The significance of the permitting requirement is that, in cases where a new source is constructed or an existing source undergoes a major modification, the owner of the facility would need to evaluate and perhaps install best available control technology (BACT) for GHG emissions.

  In November 2010, the EPA published guidance to state and local permitting authorities to undertake BACT determinations for new and modified emission sources. The guidance does not define the specific technology or technologies that should be considered BACT. The guidance does emphasize the use of energy efficiency, and specifically states that the technology of storing CO_2 under the earth, also known as carbon capture and storage, is not yet mature enough to be considered a viable alternative at this stage. On April 13, 2012, the EPA published the proposed New Source Performance Standards (NSPS) for GHG for new power plants and refineries. New or modified sources must employ BACT which is defined on a case-by-case basis and can be no less stringent than the applicable NSPS. Thus, for new power plants where the proposed NSPS identifies the applicable standard, if adopted as proposed, all permit decisions regarding BACT and application completeness should be made to reflect at least the level of stringency contained in those standards. The EPA is expected to move to regulation of existing electric generating units under the CAA. However, implementation of such regulations for existing sources is anticipated to be several years away.

- ***Climate-Related Legislation***—The federal government may consider legislative proposals to define a national energy policy and address climate change. Proposals under consideration include, but are not limited to, provisions to establish a national clean energy portfolio standard and to establish an energy efficiency resource standard. Provisions of any new proposal may present material risks and opportunities to our businesses. The final design of any legislation will determine the impact on us, which we are not now able to reasonably estimate.
- ***Regional Greenhouse Gas Initiative (RGGI)***—In response to concerns over global climate change, some states have developed initiatives to stimulate national climate legislation through CO_2 emission reductions in the electric power industry. Ten northeastern states, including New Jersey, New York and Connecticut, originally established RGGI to cap and reduce CO_2 emissions in the region. In general, these states adopted state-specific rules to enable the RGGI regulatory mandate in each state.

Applicable rules make allowances available through a regional auction whereby generators may acquire allowances that are each equal to one ton of CO_2 emissions. Generators are required to submit an allowance for each ton emitted over a three year period (e.g. 2009, 2010, and 2011). Allowances are available through the auction or through secondary markets and were required to be submitted to states by March 2012 for the first compliance period.

The Governor of New Jersey withdrew New Jersey from RGGI beginning in 2012. Therefore, our New Jersey facilities are no longer obligated to acquire CO_2 emission allowances, but our generation facilities in New York and Connecticut remain subject to RGGI. The Governor's action to withdraw has been challenged by environmental groups in the New Jersey state court.

New Jersey also adopted the Global Warming Response Act in 2007, which calls for stabilizing its GHGs emissions to 1990 levels by 2020, followed by a further reduction of greenhouse emissions to 80% below 2006 levels by 2050. To reach this goal, the NJDEP, the BPU, other state agencies and stakeholders are required to evaluate methods to meet and exceed the emission reduction targets, taking into account their economic benefits and costs.

Water Pollution Control

The Federal Water Pollution Control Act (FWPCA) prohibits the discharge of pollutants to U.S. waters from point sources, except pursuant to a National Pollutant Discharge Elimination System (NPDES) permit issued by the EPA or by a state under a federally authorized state program. The FWPCA authorizes the imposition of technology-based and water quality-based effluent limits to regulate the discharge of pollutants into surface waters and ground waters. The EPA has delegated authority to a number of state agencies, including those in New Jersey, New York and Connecticut, to administer the NPDES program through state acts. We also have ownership interests in facilities in other jurisdictions that have their own laws and implement regulations to control discharges to their surface waters and ground waters that directly govern our facilities in those jurisdictions.

In addition to regulating the discharge of pollutants, the FWPCA regulates the intake of surface waters for cooling. The use of cooling water is a significant part of the generation of electricity at steam-electric generating stations. Section 316(b) of the FWPCA requires that cooling water intake structures reflect the best technology available (BTA) for minimizing adverse environmental impact. The impact of regulations under Section 316(b) can be significant, particularly at steam-electric generating stations which do not have closed cycle cooling through the use of cooling towers to recycle water for cooling purposes. The installation of cooling towers at an existing generating station can impose significant engineering challenges and significant costs, which can affect the economic viability of a particular plant. In late 2010, the EPA entered into a settlement agreement with environmental groups that established a schedule to develop a new 316(b) rule by July 27, 2012.

In April 2011, the EPA published a new proposed rule which did not establish any particular technology as the BTA (e.g. closed-cycle cooling). Instead, the proposed rule established marine life mortality standards for existing cooling water intake structures with a design flow of more than two million gallons per day. We reviewed the proposed rule, assessed the potential impact on our generating facilities and used this information to develop our comments to the EPA which were filed in August 2011. On June 11, 2012, the EPA posted a Notice of Data Availability (NODA) requesting comment on a series of technical issues related to the impingement mortality proposed standards. On June 12, 2012, the EPA posted a second NODA outlining its plans to finalize a “Willingness to Pay” survey it initiated to develop non-use benefits data in support of the April 2011 rule proposal. PSEG and industry trade associations submitted comments on both NODAs in July 2012. In July 2012, the EPA and environmental groups agreed to delay the deadline for finalization of the Rule to June 27, 2013 to allow for more time to address public comments and analyze data submitted in response to the NODAs.

If the rule were to be adopted as proposed, the impact on us would be material since the majority of our electric generating stations would be affected. We are unable to predict the outcome of this proposed rulemaking, the final form that the proposed regulations may take and the effect, if any, that they may have on our future capital requirements, financial condition or results of operations, although such impacts could be material. See Note 13. Commitments and Contingent Liabilities for additional information.

Hazardous Substance Liability

The production and delivery of electricity, the distribution of gas and, formerly, the manufacture of gas, results in various by-products and substances classified by federal and state regulations as hazardous. These regulations may impose liability for damages to the environment from hazardous substances, including obligations to conduct environmental remediation of discharged hazardous substances as well as monetary payments, regardless of the absence of fault and the absence of any prohibitions against the activity when it occurred, as compensation for injuries to natural resources. Our historic operations and the operations of hundreds of other companies along the Passaic and Hackensack Rivers are alleged by federal and state agencies to have discharged substantial contamination into the Passaic River/Newark Bay Complex. For additional information, see Item 8. Financial Statements and Supplementary Data—Note 13. Commitments and Contingent Liabilities.

- ***Site Remediation***—The Federal Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA) and the New Jersey Spill Compensation and Control Act (Spill Act) require the remediation of discharged hazardous substances and authorize the EPA, the NJDEP and private parties to commence lawsuits to compel clean-ups or reimbursement for such remediation. The clean-ups can be more complicated and costly when the hazardous substances are in a body of water.
- ***Natural Resource Damages***—CERCLA and the Spill Act authorize the assessment of damages against persons who have discharged a hazardous substance, causing an injury to natural resources. Pursuant to the Spill Act, the NJDEP requires persons conducting remediation to characterize injuries to natural resources and to address those injuries through restoration or damages. The NJDEP adopted regulations concerning site investigation and remediation that require an ecological evaluation of potential damages to natural resources in connection with an environmental investigation of contaminated sites. The NJDEP also issued guidance to assist parties in calculating their natural resource damage liability for settlement purposes, but has stated that those calculations are applicable only for those parties that volunteer to settle a claim for natural resource damages before a claim is asserted by the NJDEP. We are currently unable to assess the magnitude of the potential financial impact of this regulatory change, although such impacts could be material.

Fuel and Waste Disposal

- ***Nuclear Fuel Disposal***—The federal government has entered into contracts with the operators of nuclear power plants for transportation and ultimate disposal of spent nuclear fuel. To pay for this service, nuclear plant owners are required to contribute to a Nuclear Waste Fund. Under the contracts, the U.S. Department of Energy (DOE) was required to begin taking possession of the spent nuclear fuel by no later than 1998 but has not yet done so. The Nuclear Waste Policy Act of 1982 requires the DOE to perform an annual review of the Nuclear Waste Fee to determine whether that fee is set appropriately to fund the national nuclear waste disposal program. In October 2009, the DOE stated that the current fee of 1/10 cent per kWh was adequate to recover program costs. In March 2011, we joined the Nuclear Energy Institute (NEI) and fifteen other nuclear plant operators in a lawsuit seeking suspension of the Nuclear Waste Fee. On June 1, 2012, The U.S. Court of Appeals for the District of Columbia ruled that the DOE failed to justify continued payments by electricity consumers into the Nuclear Waste Fund. The court ordered the DOE to conduct a complete reassessment of this fee within six months. The DOE's assessment was completed in January 2013, and concluded that fee collection should be maintained. On January 31, 2013, motions were filed with the Court seeking to reopen the case and set a schedule for expedited review of the DOE fee adequacy report.

  Spent nuclear fuel generated in any reactor can be stored in reactor facility storage pools or in Independent Spent Fuel Storage Installations located at reactors or away from reactor sites. We have on-site storage facilities that are expected to satisfy the storage needs of Salem 1, Salem 2, Hope Creek, Peach Bottom 2 and Peach Bottom 3 through the end of their operating licenses.
- ***Low Level Radioactive Waste***—As a by-product of their operations, nuclear generation units produce low level radioactive waste. Such waste includes paper, plastics, protective clothing, water purification materials and other materials. These waste materials are accumulated on site and disposed of at licensed permanent disposal facilities. New Jersey, Connecticut and South Carolina have formed the Atlantic Compact, which gives New Jersey nuclear

generators continued access to the Barnwell waste disposal facility which is owned by South Carolina. We believe that the Atlantic Compact will provide for adequate low level radioactive waste disposal for Salem and Hope Creek through the end of their current licenses including full decommissioning, although no assurances can be given. Low Level Radioactive Waste is periodically being shipped to the Barnwell site from Salem and Hope Creek. Additionally, there are on-site storage facilities for Salem, Hope Creek and Peach Bottom, which we believe have the capacity for at least five years of temporary storage for each facility.

- ***Coal Combustion Residuals (CCRs)***—In June 2010, the EPA formally published a proposed rule offering three main options for the management of CCRs under the Resource Conservation and Recovery Act. One of these options regulates CCRs as a hazardous waste and the other two options are variations of a non-hazardous designation. All options communicate the EPA's intent of ceasing wet ash transfer and instituting engineering controls on ash ponds and landfills to limit impact on human health and the environment. The outcome of the EPA rulemaking cannot be predicted. The EPA has not established a date for release of a final rule.

  On April 5, 2012, several environmental organizations and CCR marketers brought a citizens' suit against the EPA in federal court arguing that the EPA has a non-discretionary duty to issue the CCR rules by a certain date. On May 15, 2012, the Utility Solid Waste Activities Group Policy Committee filed a Motion to Intervene in order to be in alignment with the EPA in defending against the environmental organizations' action. After May 2012, all parties agreed to a schedule for submitting briefs in this case. Motions for summary judgment remain pending.

SEGMENT INFORMATION

Financial information with respect to our business segments is set forth in Item 8. Financial Statements and Supplementary Data—Note 22. Financial Information by Business Segment.

ITEM 1A. RISK FACTORS

The following factors should be considered when reviewing our business. These factors could have a material adverse impact on our financial position, results of operations or net cash flows and could cause results to differ materially from those expressed elsewhere in this document.

The factors discussed in Item 7. MD&A may also have a material adverse effect on our results of operations and cash flows and affect the market prices for our publicly-traded securities. While we believe that we have identified and discussed the key risk factors affecting our business, there may be additional risks and uncertainties that are not presently known or that are not currently believed to be significant.

We are subject to comprehensive and evolving regulation by federal, state and local regulatory agencies that affects, or may affect, our businesses.

We are subject to regulation by federal, state and local authorities. Changes in regulation can cause significant delays in or materially affect business planning and transactions and can materially increase our costs. Regulation affects almost every aspect of our businesses, such as our ability to:

- ***Obtain fair and timely rate relief***—Our utility's retail rates are regulated by the BPU and its wholesale transmission rates are regulated by the FERC. The retail rates for electric and gas distribution services are established in a base rate case and remain in effect until a new base rate case is filed and concluded. In addition, our utility has received approval for several clause recovery mechanisms, some of which provide for recovery of and on the authorized investments. These clause mechanisms require periodic updates to be reviewed and approved by the BPU. Our utility's transmission rates are recovered through a FERC approved formula rate. The revenue requirements are reset each year through this formula. Transmission ROEs have recently become the target of certain state utility commissions, municipal utilities, consumer advocates and consumer groups seeking to lower customer rates in New England and New York. These agencies and groups have filed complaints at the FERC asking the FERC to reduce the base ROE of various transmission owners. They point to changes in the capital markets as justification for lowering the ROE of these companies. While we are not the subject of any of these complaints, the matter could set a precedent for FERC-regulated transmission owners, such as PSE&G. Inability to obtain fair or timely recovery of all our costs, including a return of or on our investments in rates, could have a material impact on our business.
- ***Obtain required regulatory approvals***—The majority of our businesses operate under MBR authority granted by the FERC, which has determined that our subsidiaries do not have unmitigated market power and that MBR rules have

been satisfied. Failure to maintain MBR eligibility, or the effects of any severe mitigation measures that may be required if market power was evaluated differently in the future, could have a material adverse effect on us.

We may also require various other regulatory approvals to, among other things, buy or sell assets, engage in transactions between our public utility and our other subsidiaries, and, in some cases, enter into financing arrangements, issue securities and allow our subsidiaries to pay dividends. Failure to obtain these approvals on a timely basis could materially adversely affect our results of operations and cash flows.

- ***Comply with regulatory requirements***—There are Federal standards, including mandatory NERC and cybersecurity standards, in place to ensure the reliability of the U. S. electric transmission and generation system and to prevent major system black-outs. We have been, and will continue to be, periodically audited by the NERC for compliance.

  Further, the FERC requires compliance with all of its rules and orders, including rules concerning Standards of Conduct, market behavior and anti-manipulation rules, reporting, interlocking directorate rules and cross-subsidization. Our companies with MBR authority are currently being audited by the FERC for compliance with FERC's rules regarding MBR authority, the filing of Electric Quarterly Reports (EQRs) and the receipt of payments in organized markets by our generating units that are required to run for reliability reasons when it is not economical for them to do so.

  We will soon be subject to the reporting and record-keeping requirements of the Dodd-Frank Act, as implemented by the CFTC, and may in the future be subject to CFTC requirements regarding position limits for trading of certain commodities. As part of the Dodd-Frank Act compliance, we will need to be vigilant in monitoring and reporting our swap transactions.

  The BPU conducts periodic combined management/competitive service audits of New Jersey utilities related to affiliate standard requirements, competitive services, cross-subsidization, cost allocation and other issues. The BPU is near completion of a management audit and an affiliate transactions audit of PSE&G.

We are exposed to commodity price volatility as a result of our participation in the wholesale energy markets.

The material risks associated with the wholesale energy markets known or currently anticipated that could adversely affect our operations include:

- ***Price fluctuations and collateral requirements***—We expect to meet our supply obligations through a combination of generation and energy purchases. We also enter into derivative and other positions related to our generation assets and supply obligations. As a result, we are subject to the risk of price fluctuations that could affect our future results and impact our liquidity needs. These include:
  - variability in costs, such as changes in the expected price of energy and capacity that we sell into the market,
  - increases in the price of energy purchased to meet 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 we use to transmit electricity.

In the markets where we operate, natural gas prices typically have a major impact on the price that generators will receive for their output, especially in periods of relatively strong demand. Therefore, significant changes in the price of natural gas will usually translate into significant changes in the wholesale price of electricity.

Over the past few years, wholesale prices for natural gas have declined from the peak levels experienced in 2008. One of the reasons for this decline is increased shale gas production as extraction technology has improved. Lower gas prices have resulted in lower electricity prices, which has reduced our margins as nuclear and coal generation costs have not declined similarly. Over that time, generation by our coal units was also adversely affected by the relatively lower price of natural gas as compared to coal, making it sometimes more economical to run certain of our gas units than our coal units.

Natural gas prices may remain at low levels for an extended period and continue to decline if further advances in technology result in greater volumes of shale gas production.

Many factors may affect capacity pricing in PJM, including but not limited to:

- changes in load and demand,
- changes in the available amounts of demand response resources,
- changes in available generating capacity (including retirements, additions, derates, forced outage rates, etc.),

- increases in transmission capability between zones, and
- changes to the pricing mechanism, including increasing the potential number of zones to create more pricing sensitivity to changes in supply and demand, as well as other potential changes that PJM may propose over time, including issues currently pending at the FERC.

Potential changes to the rules governing energy markets in which the output of our plants is sold also poses risk to our business.

Also, as market prices for energy and fuel fluctuate, our forward energy sale and forward fuel purchase contracts could require us to post substantial additional collateral, thus requiring us to obtain additional sources of liquidity during periods when our ability to do so may be limited. If Power were to lose its investment grade credit rating, it would be required under certain agreements to provide a significant amount of additional collateral in the form of letters of credit or cash, which would have a material adverse effect on our liquidity and cash flows. If Power had lost its investment grade credit rating as of December 31, 2012, it may have had to provide approximately $654 million in additional collateral. We may also be subject to additional collateral requirements which could be required under new rules being developed by the CFTC which are expected to be implemented in 2013.

- ***Our cost of coal and nuclear fuel may substantially increase*** —Our coal and nuclear units have a diversified portfolio of contracts and inventory that will provide a substantial portion of our fuel needs over the next several years. However, it will be necessary to enter into additional arrangements to acquire coal and nuclear fuel in the future. Market prices for coal and nuclear fuel have recently been volatile. Although our fuel contract portfolio provides a degree of hedging against these market risks, future increases in our fuel costs cannot be predicted with certainty and could materially and adversely affect liquidity, financial condition and results of operations.
  While our generation runs on diverse fuels, allowing for flexibility, the mix of fuels ultimately used can impact earnings.
- ***Third party credit risk***—We sell generation output and buy fuel through the execution of bilateral contracts. These contracts are subject to credit risk, which relates to the ability of our counterparties to meet their contractual obligations to us. Any failure to perform by these counterparties could have a material adverse impact on our results of operations, cash flows and financial position. In the spot markets, we are exposed to the risks of whatever default mechanisms exist in those markets, 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. The impact of economic conditions may also increase such risk.

We are subject to numerous Federal and state environmental laws and regulations that may significantly limit or affect our businesses, adversely impact our business plans or expose us to significant environmental fines and liabilities.

We are subject to extensive environmental regulation by Federal, state and local authorities regarding air quality, water quality, site remediation, land use, waste disposal, aesthetics, impact on global climate, natural resources damages and other matters. These laws and regulations affect the manner in which we conduct our operations and make capital expenditures. Future changes may result in significant increases in compliance costs.

Delay in obtaining, or failure to obtain and maintain, any environmental permits or approvals, or delay in or failure to satisfy any applicable environmental regulatory requirements, could:

- prevent construction of new facilities,
- prevent continued operation of existing facilities,
- prevent the sale of energy from these facilities, or
- result in significant additional costs, each of which could materially affect our business, results of operations and cash flows.

In obtaining required approvals and maintaining compliance with laws and regulations, we focus on several key environmental issues, including:

- ***Concerns over global climate change could result in laws and regulations to limit CO_2 emissions or other GHG produced by our fossil generation facilities***—Federal and state legislation and regulation designed to address global climate change through the reduction of GHG emissions could materially impact our fossil generation facilities. Legislation enacted in the states where our generation facilities are located establishes aggressive goals for the reduction of CO_2 emissions over a 40-year period. There could be significant costs incurred to continue operation of our fossil generation facilities, including the potential need to purchase CO_2 emission allowances. Such expenditures could materially affect the continued economic viability of one or more such facilities. Multiple states are developing or have developed state-specific or regional initiatives to obtain CO_2 emissions reductions in the electric power industry. The RGGI is such a program in the northeast.

- ***CO_2 Litigation***—In addition to legislative and regulatory initiatives, the outcome of certain legal proceedings regarding alleged impacts of global climate change not involving us could be material to the future liability of energy companies.

  In June 2012, the United States Court of Appeals for the D.C. Circuit upheld the EPA finding that GHGs could reasonably be expected to endanger public health and welfare. However, the Court dismissed the action brought by individuals, local governments and interest groups alleging that various industries, including various energy companies, emitted GHGs, causing global climate change resulting in a variety of damages. Plaintiffs are expected to appeal to the United States Supreme Court.

  In November 2012, the Ninth Circuit Court of Appeals refused to reconsider its decision not to rehear an Alaskan village's public nuisance lawsuit alleging that GHGs emissions from ExxonMobil Corporation and many other energy companies had made the village uninhabitable. The appellate court denied the petition for rehearing which accused these companies of causing GHGs emissions that contributed to global warming and alleged injury to the village. If relevant federal or state common law were to develop that imposed liability upon those that emit GHGs for alleged impacts of GHGs emissions, such potential liability to us could be material.

- ***Potential closed-cycle cooling requirements***—Our Salem nuclear generating facility has a permit from the NJDEP allowing for its continued operation with its existing cooling water system. That permit expired in July 2006. Our application to renew the permit, filed in February 2006, estimated the costs associated with cooling towers for Salem to be approximately $1 billion, of which our share was approximately $575 million. These amounts have not been updated since our 2006 filing.

  If the NJDEP and the Connecticut Department of Environmental Protection were to require installation of closed-cycle cooling or its equivalent at our Salem, Mercer, Hudson, Bridgeport, Sewaren or New Haven generating stations, the related increased costs and impacts would be material to our financial position, results of operations and net cash flows and would require further economic review to determine whether to continue operations or decommission the stations.

  The EPA issued a proposed rule in 2011 regarding regulation of cooling water intake structures. If adopted as proposed, the impact of this rulemaking could significantly impact states' permitting decisions on whether to require closed cycle cooling and could materially increase our cost of compliance. For additional information, see Item 8. Financial Statements and Supplementary Data—Note 13. Commitments and Contingent Liabilities.

- ***Remediation of environmental contamination at current or formerly owned facilities*** —We are subject to liability under environmental laws for the costs of remediating environmental contamination of property now or formerly owned by us and of property contaminated by hazardous substances that we generated. Remediation activities associated with our former Manufactured Gas Plant (MGP) operations are one source of such costs. Also, we are currently involved in a number of proceedings relating to sites where other hazardous substances may have been discharged and may be subject to additional proceedings in the future, the related costs of which could have a material adverse effect on our financial condition, results of operations and cash flows. Recent amendments to New Jersey law now place affirmative obligations on us to investigate and, if necessary, remediate contaminated property upon which we were in any way responsible for a discharge of hazardous substances. While those amendments do not change our liability, they do impact the speed by which we will need to investigate contaminated properties, which could adversely impact cash flow.

  The State of New Jersey has filed multiple lawsuits against parties, including us, who were alleged to be responsible for injuries to natural resources in New Jersey, including a site being remediated under our MGP program. We cannot predict what further actions, if any, or the costs or the timing thereof, that may be required with respect to these or other natural resource damages claims. For additional information, see Item 8. Financial Statements and Supplementary Data—Note 13. Commitments and Contingent Liabilities.

- ***More stringent air pollution control requirements in New Jersey*** —Most of our generating facilities are located in New Jersey where restrictions are generally considered to be more stringent in comparison to other states. Therefore, there may be instances where the facilities located in New Jersey are subject to more restrictive and, therefore, more costly pollution control requirements and liability for damage to natural resources, than competing facilities in other states. Most of New Jersey has been classified as "nonattainment" with NAAQS for one or more air pollutants. This requires New Jersey to develop programs to reduce air emissions. Such programs can impose additional costs on us by requiring that we offset any emissions increases from new electric generators we may want to build and by setting more stringent emission limits on our facilities that run during the hottest days of the year.

- ***Coal Ash Management***—Coal ash is a CCR produced as a byproduct of generation at our coal-fired facilities. We currently have a program to beneficially reuse coal ash as presently allowed by federal and state regulations. In June 2010, the EPA formally published a proposed rule offering three main options for the management of CCRs under the Resource Conservation and Recovery Act. One of these options regulates CCRs as a hazardous waste and the other two options are variations of a non-hazardous designation. All options communicate the EPA's intent of ceasing wet ash transfer and instituting engineering controls on ash ponds and landfills to limit impact on human health and the environment. The outcome of the EPA rulemaking cannot be predicted. Proposed regulations which more stringently regulate coal ash, including regulating coal ash as hazardous waste, could materially increase costs at our coal-fired generation facilities. The EPA has not established a date for release of a final rule.

Our ownership and operation of nuclear power plants involve regulatory, financial, environmental, health and safety risks.

Approximately half of our total generation output each year is provided by our nuclear fleet, which comprises approximately one-fourth of our total owned generation capacity. For this reason, we are exposed to risks related to the continued successful operation of our nuclear facilities and issues that may adversely affect the nuclear generation industry. These include:

- ***Storage and Disposal of Spent Nuclear Fuel***—We currently use on-site storage for spent nuclear fuel. Disposal of nuclear materials, including the availability or unavailability of a permanent repository for spent nuclear fuel, could impact future operations of these stations. In addition, the availability of an off-site repository for spent nuclear fuel may affect our ability to fully decommission our nuclear units in the future.
- ***Regulatory and Legal Risk***—The NRC may modify, suspend or revoke licenses, or shut down a nuclear facility and impose substantial civil penalties for failure to comply with the Atomic Energy Act, related regulations or the terms and conditions of the licenses for nuclear generating facilities. As with all of our generation facilities, as discussed above, our nuclear facilities are also subject to comprehensive, evolving environmental regulation. Our nuclear generating facilities are currently operating under NRC licenses that expire in 2033 through 2046.
- ***Operational Risk***—Operations at any of our nuclear generating units could degrade to the point where the affected unit needs to be shut down or operated at less than full capacity. If this were to happen, identifying and correcting the causes may require significant time and expense. Since our nuclear fleet provides the majority of our generation output, any significant outage could result in reduced earnings as we would need to purchase or generate higher-priced energy to meet our contractual obligations.
- ***Nuclear Incident or Accident Risk***—Accidents and other unforeseen problems have occurred at nuclear stations, both in the United States and elsewhere. The consequences of an accident can be severe and may include loss of life, significant property damage and/or a change in the regulatory climate. We have nuclear units at two sites. It is possible that an accident or other incident at a nuclear generating unit could adversely affect our ability to continue to operate unaffected units located at the same site, which would further affect our financial condition, operating results and cash flows. An accident or incident at a nuclear unit not owned by us could also affect our ability to continue to operate our units. Any resulting financial impact from a nuclear accident may exceed our resources, including insurance coverages.

We may be adversely affected by changes in energy regulatory policies, including energy and capacity market design rules and developments affecting transmission.

The energy industry continues to be regulated and the rules to which our businesses are subject are always at risk of being changed. Our business has been impacted by established rules that create locational capacity markets in each of PJM, ISO-NE and NYISO. Under these rules, generators located in constrained areas are paid more for their capacity so there is an incentive to locate in those areas where generation capacity is most needed. Because much of our generation is located in constrained areas in PJM and ISO-NE, the existence of these rules has had a positive impact on our revenues. PJM's locational capacity market design rules and New England forward capacity market rules have been challenged in court and continue to evolve. Any changes to these rules may have an adverse impact on our financial condition, results of operations and cash flows.

In addition, legislative developments in the State of New Jersey have the potential to adversely impact RPM prices. In January 2011, New Jersey enacted a law establishing a LCAPP which provides for the construction of subsidized base load or mid-merit electric power generation. The LCAPP may have the effect of artificially depressing prices in the competitive wholesale market on both a short-term and long-term basis. PJM's Independent Market Monitor has released a report estimating that the impact of bidding 2,000 MW of capacity in New Jersey as a price taker could be a reduction in capacity market revenues to PJM suppliers of more than $2 billion in the first year.

We could also be impacted by a number of other events, including regulatory or legislative actions favoring non-competitive markets and energy efficiency and demand response initiatives. Further, some of the market-based mechanisms in which we participate, including BGS auctions, are at times the subject of review or discussion by some of the participants in the New Jersey and Federal regulatory and political arenas. We can provide no assurance that these mechanisms will continue to exist in their current form, nor otherwise be modified.

To the extent that additions to the transmission system relieve or reduce congestion in eastern PJM where most of our plants are located, Power's revenues could be adversely affected. Moreover, the FERC has issued a rule, currently being challenged in court, that requires changes to transmission planning processes which may result in more transmission being built to facilitate renewable generation. This rule has also opened up the construction of certain types of transmission to competition through elimination of the ROFR.

Changes in the current policies for building new transmission lines could result in additional competition to build transmission lines in our service territory in the future and would allow us to seek opportunities to build in other service territories.

We face significant competition in the merchant energy markets.

Our wholesale power and marketing businesses are subject to significant competition that may adversely affect our ability to make investments or sales on favorable terms and achieve our annual objectives. Increased competition could contribute to a reduction in prices offered for power and could result in lower earnings. Decreased competition could negatively impact results through a decline in market liquidity. Some of our competitors include:

- merchant generators,
- domestic and multi-national utility rate-based generators,
- energy marketers,
- utilities,
- banks, funds and other financial entities,
- fuel supply companies, and
- affiliates of other industrial companies.

Regulatory, environmental, industry and other operational developments will have a significant impact on our ability to compete in energy markets, potentially resulting in erosion of our market share and impairment in the value of our power plants. Our ability to compete will also be impacted by:

- ***DSM and other efficiency efforts***—DSM and other efficiency efforts aimed at changing the quantity and patterns of consumers' usage could result in a reduction in load requirements.
- ***Changes in technology and/or customer conservation*** —It is possible that advances in technology will reduce the cost of alternative methods of producing electricity, such as fuel cells, micro turbines, windmills and PV (solar) cells, to a level that is competitive with that of most central station electric production. It is also possible that electric customers may significantly decrease their electric consumption due to demand-side energy conservation programs. Changes in technology could also alter the channels through which retail electric customers buy electricity, which could adversely affect our financial results.

Our inability to balance energy obligations with available supply could negatively impact results.

The revenues generated by the operation of our generating stations are subject to market risks that are beyond our control. Generation output will either be used to satisfy wholesale contract requirements, other bilateral contracts or be sold into competitive power markets. Participants in the competitive power markets are not guaranteed any specified rate of return on their capital investments. Generation revenues and results of operations are dependent upon prevailing market prices for energy, capacity, ancillary services and fuel supply in the markets served.

Our generation business frequently involves the establishment of forward sale positions in the wholesale energy markets on long-term and short-term bases. To the extent that we have produced or purchased energy in excess of our contracted obligations, a reduction in market prices could reduce profitability. Conversely, to the extent that we have contracted obligations in excess of energy we have produced or purchased, an increase in market prices could reduce profitability. If the strategy we utilize to hedge our exposure to these various risks is not effective, we could incur significant losses. Our market positions can also be adversely affected by the level of volatility in the energy markets that, in turn, depends on various factors, including weather in various geographical areas, short-term supply and demand imbalances, customer migration and pricing differentials at various geographic locations. These cannot be predicted with certainty.

Increases in market prices also affect our ability to hedge generation output and fuel requirements as the obligation to post margin increases with increasing prices and could require the maintenance of liquidity resources that would be prohibitively expensive.

Any inability to recover the carrying amount of our assets could result in future impairment charges which could have a material adverse impact on our financial condition, results of operations and cash flows.

In accordance with accounting guidance, management evaluates long-lived assets for impairment whenever events or changes in circumstances, such as significant adverse changes in regulation, business climate or market conditions, could potentially indicate an asset's or group of assets' carrying amount may not be recoverable. Significant reductions in our expected revenues or cash flows for an extended period of time resulting from such events could result in future asset impairment charges, which could have a material adverse impact on our financial condition and results of operations.

Inability to access sufficient capital at reasonable rates or commercially reasonable terms or maintain sufficient liquidity in the amounts and at the times needed could adversely impact our business.

Capital for projects and investments has been provided primarily by internally-generated cash flow and external financings. We have significant capital requirements and will need continued access to debt capital from outside sources in order to efficiently fund the construction and other cash flow needs of our businesses. The ability to arrange financing and the costs of capital depend on numerous factors including, among other things, general economic and market conditions, the availability of credit from banks and other financial institutions, investor confidence, the success of current projects and the quality of new projects.

The ability to have continued access to the credit and capital markets at a reasonable economic cost is dependent upon our current and future capital structure, financial performance, our credit ratings and the availability of capital under reasonable terms and conditions. As a result, no assurance can be given that we will be successful in obtaining re-financing for maturing debt, financing for projects and investments or funding the equity commitments required for such projects and investments in the future.

Financial market performance directly affects the asset values of our nuclear decommissioning trust funds and defined benefit plan trust funds. Sustained decreases in asset value of trust assets could result in the need for significant additional funding.

The performance of the financial markets will affect the value of the assets that are held in trust to satisfy our future obligations under our pension and postretirement benefit plans and to decommission our nuclear generating plants. A decline in the market value of our pension assets similar to the one experienced in 2008 could result in the need for us to make significant contributions in the future to maintain our funding at sufficient levels.

An extended economic recession would likely have a material adverse effect on our businesses.

Our results of operations may be negatively affected by sustained downturns or sluggishness in the economy, including low levels in the market prices of commodities. Adverse conditions in the economy affect the markets in which we operate and can negatively impact our results. Declines in demand for energy will reduce overall sales and lessen cash flows, especially as customers reduce their consumption of electricity and gas. Although our utility business is subject to regulated allowable rates of return, overall declines in electricity and gas sold and/or increases in non-payment of customer bills would materially adversely affect our liquidity, financial condition and results of operations.

We may be adversely affected by equipment failures, accidents, severe weather events or other incidents that impact our ability to provide safe and reliable service to our customers and remain competitive.

The success of our businesses is dependent on our ability to continue providing safe and reliable service to our customers while minimizing service disruptions. We are also exposed to the risk of accidents, severe weather events such as we experienced from Hurricane Irene and Superstorm Sandy, or other incidents which could result in damage to or destruction of our facilities or damage to persons or property. The physical risks of climate change, such as more frequent or more extreme weather events, changes in temperature and precipitation patterns and other related phenomena have exacerbated these risks. Such issues experienced at our facilities, or by others in our industry, could adversely impact our revenues, increase costs to repair and maintain our systems, subject us to potential litigation and/or damage claims and increase the level of oversight of our utility and generation operations and infrastructure through investigations or through the imposition of additional regulatory or legislative requirements. Such actions could affect our costs, competitiveness and future investments, which could be material to our financial position, results of operations and cash flow.

Acts of war, terrorism or cybersecurity breaches could adversely affect our operations.

Our businesses and industry may be impacted by acts and threats of war or terrorism. These actions could result in increased political, economic and financial market instability and volatility in fuel prices which could materially adversely affect our operations. In addition, our infrastructure facilities, such as our generating stations, transmission and distribution facilities and information management systems for customer-related operations, could be direct or indirect targets or be affected by terrorist or other criminal activity.

Our businesses could also be impacted by cybersecurity breaches. Cybersecurity threats include:

- operational interference, such as attacks on our generation facilities, transmission lines or the power grid,
- information theft as to employees, shareholders, vendors and/or customers, such as personal financial and health records, and
- business system interruption or compromise.

Such events could severely disrupt business operations and prevent us from servicing our customers or collecting revenues. These events could also result in significant expenses to repair security breaches or system damage as well as increased capital, insurance and operating costs, including increased security costs for our facilities. A breach of certain business systems could affect our ability to record, process and/or report financial information correctly. In addition, new or updated security regulations may require us to make changes to our current measures which could also result in additional expenses.

Inability to successfully develop or construct generation, transmission and distribution projects within budget could adversely impact our businesses.

Our business plan calls for extensive investment in capital improvements and additions, including the installation of required environmental upgrades and retrofits, construction and/or acquisition of additional generation units and transmission facilities and modernizing existing infrastructure. Currently, we have several significant projects underway or being contemplated.

Our success will depend, in part, on our ability to complete these projects within budgets, on commercially reasonable terms and conditions and, in our regulated businesses, our ability to recover the related costs through rates. Any delays, cost escalations or otherwise unsuccessful construction and development could materially affect our financial position, results of operations and cash flows.

We may be unable to achieve, or continue to sustain, our expected levels of operating performance.

One of the key elements to achieving the results in our business plan is the ability to sustain generating operating performance and capacity factors at expected levels since our forward sales of energy and capacity assume acceptable levels of operating performance. This is especially important at our lower-cost facilities. Operations at any of our plants could degrade to the point where the plant has to shut down or operate at less than full capacity. Some issues that could impact the operation of our facilities are:

- breakdown or failure of equipment, processes or management effectiveness,
- disruptions in the transmission of electricity,
- labor disputes,
- fuel supply interruptions,
- transportation constraints,
- limitations which may be imposed by environmental or other regulatory requirements,
- permit limitations, and
- operator error or catastrophic events such as fires, earthquakes, explosions, floods, severe storms, acts of terrorism or other similar occurrences.

Identifying and correcting any of these issues may require significant time and expense. Depending on the materiality of the issue, we may choose to close a plant rather than incur the expense of restarting it or returning it to full capacity. In either event, to the extent that our operational targets are not met, we could have to operate higher-cost generation facilities or meet our obligations through higher-cost open market purchases.

Challenges associated with retention of a qualified workforce could adversely impact our businesses.

Our operations depend on the retention of a skilled workforce. The loss or retirement of key executives or other employees, including those with the specialized knowledge required to support our generation, transmission and distribution operations, could result in various operational challenges. These challenges may include the lack of appropriate replacements, the loss of institutional and industry knowledge and the increased costs to hire and train new personnel. This has the potential to become more critical over the next several years as a growing number of employees become eligible to retire.

In addition, because a significant portion of our employees are covered under collective bargaining agreements, our success will depend on our ability to successfully renegotiate these agreements as they expire. Inability to do so may result in employee strikes or work stoppages which would disrupt our operations and could also result in increased costs.

Our receipt of payment of receivables related to our domestic leveraged leases is dependent upon the credit quality and the ability of lessees to meet their obligations.

Our receipt of payments of equity rent, debt service and other fees related to our leveraged lease portfolio in accordance with the lease contracts can be impacted by various factors. The factors which may impact future lease cash flow include, but are not limited to, new environmental legislation regarding air quality and other discharges in the process of generating electricity, market prices for fuel and electricity, including the impact of low gas prices on our coal generation investments, overall financial condition of lease counterparties and the quality and condition of assets under lease. If a lessee were to default, we could potentially be required to impair our current investment balances. For additional information relating to these leases, see Item 7. MD&A—Critical Accounting Estimates and Item 8. Financial Statements and Supplementary Data—Note 8. Financing Receivables.

ITEM 1B. UNRESOLVED STAFF COMMENTS

PSEG, Power and PSE&G

None.

ITEM 2. PROPERTIES

Our subsidiaries own all of our physical property. We believe that we and our subsidiaries maintain adequate insurance coverage against loss or damage to plants and properties, subject to certain exceptions, to the extent such property is usually insured and insurance is available at a reasonable cost. For a discussion of nuclear insurance, see Item 8. Financial Statements and Supplementary Data—Note 13. Commitments and Contingent Liabilities.

Generation Facilities

Power

As of December 31, 2012, Power's share of summer installed generating capacity is shown in the following table:

Name	Location	Total Capacity (MW)	% Owned	Owned Capacity (MW)	Principal Fuels Used	Mission
Steam:						
Hudson	NJ	620	100%	620	Coal/Gas	Load Following
Mercer	NJ	632	100%	632	Coal/Gas	Load Following
Sewaren	NJ	453	100%	453	Gas	Load Following
Keystone (A)	PA	1,711	23%	391	Coal	Base Load
Conemaugh (A)	PA	1,711	23%	385	Coal	Base Load
Bridgeport Harbor	CT	383	100%	383	Coal	Load Following
New Haven Harbor	CT	448	100%	448	Oil	Load Following
Total Steam		**5,958**		**3,312**		
Nuclear:						
Hope Creek	NJ	1,174	100%	1,174	Nuclear	Base Load
Salem 1 & 2	NJ	2,326	57%	1,335	Nuclear	Base Load
Peach Bottom 2 & 3 (B)	PA	2,245	50%	1,123	Nuclear	Base Load
Total Nuclear		**5,745**		**3,632**		
Combined Cycle:						
Bergen	NJ	1,183	100%	1,183	Gas	Load Following
Linden	NJ	1,236	100%	1,236	Gas	Load Following
Bethlehem	NY	757	100%	757	Gas	Load Following
Total Combined Cycle		**3,176**		**3,176**		
Combustion Turbine:						
Essex	NJ	617	100%	617	Gas	Peaking
Edison	NJ	504	100%	504	Gas	Peaking
Kearny	NJ	463	100%	463	Gas	Peaking
Burlington	NJ	557	100%	557	Oil/Gas	Peaking
Linden	NJ	340	100%	340	Gas	Peaking
Mercer	NJ	115	100%	115	Oil	Peaking
Sewaren	NJ	105	100%	105	Oil	Peaking
Bergen	NJ	21	100%	21	Gas	Peaking
National Park	NJ	21	100%	21	Oil	Peaking
Salem	NJ	38	57%	22	Oil	Peaking
New Haven Harbor	CT	129	100%	129	Gas/Oil	Peaking
Bridgeport Harbor	CT	12	100%	12	Oil	Peaking
Total Combustion Turbine		**2,922**		**2,906**		
Pumped Storage:						
Yards Creek (C)	NJ	400	50%	200		Peaking
Total Power Plants		**18,201**		**13,226**		

(A) Operated by GenOn Northeast Management Company

(B) Operated by Exelon Generation

(C) Operated by Jersey Central Power & Light Company

PSE&G

As of December 31, 2012, PSE&G had 73 MW of installed solar capacity throughout New Jersey.

Energy Holdings

Energy Holdings had investments in the following generation facilities as of December 31, 2012:

Name	Location	Total Capacity (MW)	% Owned	Owned Capacity (MW)	Principal Fuels Used
Kalaeloa	HI	209	50%	105	Oil
Hackettstown	NJ	2	100%	2	Solar
Wyandot	OH	12	100%	12	Solar
Jacksonville	FL	15	100%	15	Solar
Queen Creek	AZ	25	100%	25	Solar
Milford	DE	15	100%	15	Solar
Total Operating Power Plants		**278**		**174**	

Transmission and Distribution Facilities

As of December 31, 2012, PSE&G's electric transmission and distribution system included 23,856 circuit miles, of which 8,357 circuit miles were underground, and 838,236 poles, of which 546,614 poles were jointly-owned. Approximately 99% of this property is located in New Jersey.

In addition, as of December 31, 2012, PSE&G owned four electric distribution headquarters and five subheadquarters in four operating divisions, all located in New Jersey.

As of December 31, 2012, the daily gas capacity of PSE&G's 100%-owned peaking facilities (the maximum daily gas delivery available during the three peak winter months) consisted of liquid petroleum air gas (LPG) and liquefied natural gas (LNG) and aggregated 2,790,500 therms (270,932,330 cubic feet on an equivalent basis of 100,000 Btu/therm and 1,030 Btu/cubic foot) as shown in the following table:

Plant	Location	Daily Capacity (Therms)
Burlington LNG	Burlington, NJ	670,500
Camden LPG	Camden, NJ	320,000
Central LPG	Edison, NJ	900,000
Harrison LPG	Harrison, NJ	900,000
Total		**2,790,500**

As of December 31, 2012, PSE&G owned and operated 17,713 miles of gas mains, owned 12 gas distribution headquarters and two subheadquarters, all in four operating regions located in New Jersey and owned one meter shop in New Jersey serving all such areas. In addition, PSE&G operated 62 natural gas metering and regulating stations, all located in New Jersey, of which 26 were located on land owned by customers or natural gas pipeline suppliers and were operated under lease, easement or other similar arrangement. In some instances, the pipeline companies owned portions of the metering and regulating facilities.

PSE&G's First and Refunding Mortgage, securing the bonds issued thereunder, constitutes a direct first mortgage lien on substantially all of PSE&G's property.

PSE&G's electric lines and gas mains are located over or under public highways, streets, alleys or lands, except where they are located over or under property owned by PSE&G or occupied by it under easements or other rights. PSE&G deems these easements and other rights to be adequate for the purposes for which they are being used.

In addition, as of December 31, 2012, PSE&G owned 42 switching stations in New Jersey with an aggregate installed capacity of 25,103 megavolt-amperes (MVA) and 246 substations with an aggregate installed capacity of 8,179 MVA. In addition, four of our substations in New Jersey having an aggregate installed capacity of 109 MVA were operated on leased property.

ITEM 3. LEGAL PROCEEDINGS

We are party to various lawsuits and regulatory matters, including in the ordinary course of business. For information regarding material legal proceedings, other than those discussed below, see Item 1. Business—Regulatory Issues and Environmental Matters and Item 8. Financial Statements and Supplementary Data—Note 13. Commitments and Contingent Liabilities.

Con Edison (Con Ed)

In 2001, Con Ed filed a complaint with the FERC against PSE&G, PJM and NYISO asserting a failure to comply with agreements between PSE&G and Con Ed covering 1,000 MW of transmission. On September 16, 2010, the FERC approved a settlement agreement entered into by PSE&G, Con Ed, PJM, NYISO and others. This settlement provides the basis for moving forward with Con Ed after the current contracts expire in 2012 and settles all issues associated with the existing contracts, including cases pending in the D.C. Circuit Court of Appeals. However, dismissal of these court cases is contingent upon receipt of a final, non-appealable order from the FERC. One party to the proceeding sought rehearing of the FERC approval order, which the FERC denied in an order issued on April 8, 2011. The party then appealed this decision to the D.C. Circuit Court of Appeals. This appeal is pending.

Electric Discount and Energy Competition Act (Competition Act)

In 2007, PSE&G and Transition Funding were served with a purported class action complaint (Complaint) in New Jersey Superior Court challenging the constitutional validity of certain stranded cost recovery provisions of the Competition Act, seeking injunctive relief against continued collection from PSE&G's electric customers of the Transition Bond Charge (TBC) of Transition Funding, as well as recovery of TBC amounts previously collected. The Superior Court subsequently granted PSE&G's motion to dismiss the Complaint, which dismissal was upheld by the Appellate Division.

In July 2007, the same plaintiff also filed a petition with the BPU requesting review and adjustment to PSE&G's recovery of the same stranded cost charges. In June 2010, the BPU granted PSE&G's motion to dismiss, and the plaintiff/petitioner subsequently appealed this dismissal to the Appellate Division. In June 2012, the Appellate Division affirmed the BPU's decision, concluding that the BPU had correctly found that the plaintiff's claims failed as a matter of law. The petitioner subsequently filed a Notice of Petition for Certification with the New Jersey Supreme Court. By order dated November 16, 2012, the New Jersey Supreme Court denied this Notice. On February 11, 2013, the Court denied the plaintiff's subsequent motion for reconsideration.

Environmental Matters

The following items are environmental matters involving governmental authorities not discussed elsewhere in this Form 10-K. We do not expect expenditures for any such site relating to the items listed below, individually or for all such current sites in the aggregate, to have a material effect on our financial condition, results of operations and net cash flows.

(1) Claim made in 1985 by the U.S. Department of the Interior under CERCLA with respect to the Pennsylvania Avenue and Fountain Avenue municipal landfills in Brooklyn, New York, for damages to natural resources. The United States Government alleges damages of approximately $200 million. To PSE&G's knowledge there has been no action on this matter since 1988.

(2) Various Spill Act directives were issued by the NJDEP to PRPs, including PSE&G with respect to the PJP Landfill in Jersey City, Hudson County, New Jersey, ordering payment of costs associated with operation and maintenance, interim remedial measures and a Remedial Investigation and Feasibility Study (RI/FS) in excess of $25 million. The directives also sought reimbursement of the NJDEP's past and future oversight costs and the costs of any future remedial action.

(3) Claim by the EPA, Region III, under CERCLA with respect to a Cottman Avenue Superfund Site, a former non-ferrous scrap reclamation facility located in Philadelphia, Pennsylvania, owned and formerly operated by Metal Bank of America, Inc. PSE&G, other utilities and other companies are alleged to be liable for contamination at the site and PSE&G has been named as a PRP. A Final Remedial Design Report was submitted to the EPA in September of 2002. This document presented the design details of the EPA's selected remediation remedy. PSE&G and other utility companies as members of a PRP group entered into a Consent Decree and agreed to implement a negotiated EPA selected remediation remedy. The PRP group implementation of the remedy was completed in 2010. Although subject to EPA approval and oversight, long term monitoring activities designed to demonstrate the effectiveness of the implemented remedy are planned through 2018 at an estimated cost of $2.8 million.

(4) The Klockner Road site is located in Hamilton Township, Mercer County, New Jersey, and occupies approximately two acres on PSE&G's Trenton Switching Station property. In 1996, PSE&G entered into a memorandum of

agreement with the NJDEP for the Klockner Road site pursuant to which PSE&G conducted an RI/FS and remedial action at the site to address the presence of soil and groundwater contamination. Anticipated future activities at the site include the filing of certification(s) with the NJDEP once every two years regarding the effectiveness of engineering and institutional controls, quarterly groundwater monitoring for several years and the installation of additional off-site groundwater monitoring wells as directed by the NJDEP.

(5) In 1996, Morton International, Inc., a subsidiary of The Dow Chemical Company, filed a lawsuit against the former customers of a former mercury refining operation located on the banks of Berry's Creek in Wood-Ridge, New Jersey. The lawsuit seeks to recover cleanup costs incurred and to be incurred in remediating the site. PSE&G was among the former customers sued based on allegations that mercury originating at its Kearny Generating Station was sent to the site for refining.

(6) The EPA sent Power, PSE&G and approximately 157 other entities a notice that the EPA considered each of the entities to be a PRP with respect to contamination in Berry's Creek in Bergen County, New Jersey and requesting that the PRPs perform a RI/FS on Berry's Creek and the connected tributaries and wetlands. Berry's Creek flows through approximately 6.5 miles of areas that have been used for a variety of industrial purposes and landfills. The EPA estimates that the study could be completed in approximately five years at a total cost of approximately $18 million. As members of a PRP Group, Power and certain of the other entities named in the EPA Notice entered into an Administrative Settlement Agreement and Order on Consent to conduct the RI/FS.

(7) In January 2010, we received a letter from the NJDEP asserting that we are the current owner of the Gates Construction Corporation Landfill and that the subject landfill has not been properly closed in accordance with NJDEP Solid Waste Regulations.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock is listed on the New York Stock Exchange, Inc. As of December 31, 2012, there were 78,842 registered holders.

The graph below shows a comparison of the five-year cumulative return assuming $100 invested on December 31, 2007 in our common stock and the subsequent reinvestment of quarterly dividends, the S&P Composite Stock Price Index, the Dow Jones Utilities Index and the S&P Electric Utilities Index.

	2007	2008	2009	2010	2011	2012
PSEG	$ 100.00	$ 61.55	$ 73.15	$ 73.09	$ 79.08	$ 76.68
S&P 500	$ 100.00	$ 63.06	$ 79.70	$ 91.68	$ 93.63	$ 108.55
DJ Utilities	$ 100.00	$ 72.22	$ 81.18	$ 86.41	$ 103.34	$ 104.70
S&P Electrics	$ 100.00	$ 74.20	$ 76.68	$ 76.68	$ 95.92	$ 95.37

The following table indicates the high and low sale prices for our common stock and dividends paid for the periods indicated:

Common Stock	High	Low	Dividend per Share
2012			
First Quarter	$ 33.25	$ 29.59	$ 0.3550
Second Quarter	$ 32.51	$ 28.92	$ 0.3550
Third Quarter	$ 34.07	$ 31.19	$ 0.3550
Fourth Quarter	$ 33.36	$ 29.05	$ 0.3550
2011			
First Quarter	$ 33.12	$ 30.15	$ 0.3425
Second Quarter	$ 34.22	$ 30.30	$ 0.3425
Third Quarter	$ 35.48	$ 27.97	$ 0.3425
Fourth Quarter	$ 34.96	$ 30.60	$ 0.3425

On February 19, 2013, our Board of Directors approved $0.36 per share of common stock dividend for the first quarter of 2013. This reflects an indicated annual dividend rate of $1.44 per share.

The following table indicates our common share repurchases in the open market to satisfy obligations under various equity compensation award grants during the fourth quarter of 2012:

Three Months Ended December 31, 2012	Total Number of Shares Purchased	Average Price Paid per Share
October 1-October 31	—	$ —
November 1-November 30	50,000	$ 30.36
December 1-December 31	31,000	$ 30.01

The following table indicates the securities authorized for issuance under equity compensation plans as of December 31, 2012:

Plan Category	Number of Securities to be Issued upon Exercise of Outstanding Options, Warrants and Rights	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance under Equity Compensation Plans	
Equity compensation plans approved by security holders	2,945,400	$ 34.19	17,013,520	(A)
Equity compensation plans not approved by security holders	—	$ —	3,589,032	(B)
Total	**2,945,400**	**$ 34.19**	**20,602,552**	

(A) Shares issuable under our Long-Term Incentive Plan.
(B) Shares issuable under our Employee Stock Purchase Plan.

For additional discussion of specific plans concerning equity-based compensation, see Item 8. Financial Statements and Supplementary Data—Note 18. Stock Based Compensation.

Power

We own all of Power's outstanding limited liability company membership interests. For additional information regarding Power's ability to pay dividends, see Item 7. MD&A—Overview of 2012 and Future Outlook.

PSE&G

We own all of the common stock of PSE&G. For additional information regarding PSE&G's ability to continue to pay dividends, see Item 7. MD&A —Overview of 2012 and Future Outlook.

ITEM 6. SELECTED FINANCIAL DATA

PSEG

The information presented below should be read in conjunction with the MD&A and the Consolidated Financial Statements and Notes to Consolidated Financial Statements (Notes).

PSEG	2012	2011	2010	2009	2008
Years Ended December 31,	Millions, except Earnings per Share				
Operating Revenues	$ 9,781	$ 11,079	$ 11,793	$ 12,035	$ 12,609
Income from Continuing Operations (A)	$ 1,275	$ 1,407	$ 1,557	$ 1,594	$ 918
Net Income	$ 1,275	$ 1,503	$ 1,564	$ 1,592	$ 1,188
Earnings per Share:					
Income from Continuing Operations					
Basic (A)	$ 2.52	$ 2.78	$ 3.08	$ 3.15	$ 1.81
Diluted (A)	$ 2.51	$ 2.77	$ 3.07	$ 3.14	$ 1.81
Net Income					
Basic	$ 2.52	$ 2.97	$ 3.09	$ 3.15	$ 2.34
Diluted	$ 2.51	$ 2.96	$ 3.08	$ 3.14	$ 2.34
Dividends Declared per Share	$ 1.42	$ 1.37	$ 1.37	$ 1.33	$ 1.29
As of December 31:					
Total Assets	$ 31,725	$ 29,821	$ 29,909	$ 28,678	$ 29,049
Long-Term Obligations (B)	$ 6,701	$ 7,482	$ 7,847	$ 7,679	$ 8,044

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(A) Income from Continuing Operations for 2011 and 2008 includes after-tax charges of $ 170 million and $490 million, respectively, related to certain leveraged leases.

(B) Includes capital lease obligations.

Power and PSE&G

Omitted pursuant to conditions set forth in General Instruction I of Form 10-K.

ITEM 7. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (MD&A)

This combined MD&A is separately filed by Public Service Enterprise Group Incorporated (PSEG), PSEG Power LLC (Power) and Public Service Electric and Gas Company (PSE&G). Information contained herein relating to any individual company is filed by such company on its own behalf. Power and PSE&G each make representations only as to itself and make no representations whatsoever as to any other company.

PSEG's business consists of three reportable segments, which are:

- **Power,** our wholesale energy supply company that integrates its generating asset operations with its wholesale energy, fuel supply, energy trading and marketing and risk management activities primarily in the Northeast and Mid-Atlantic United States,
- **PSE&G,** our public utility company which provides transmission and distribution of electric energy and gas in New Jersey; implements demand response and energy efficiency programs and invests in solar generation, and
- **Energy Holdings,** which principally owns and manages a portfolio of lease investments and solar generation projects.

Our business discussion in Part I, Item 1. Business provides a review of the regions and markets where we operate and compete, as well as our strategy for conducting our businesses within these markets, focusing on operational excellence, financial strength and making disciplined investments. Our risk factor discussion in Part I Item 1A provides information about factors that could have a material adverse impact on our businesses. The following discussion provides an overview of the significant events and business developments that have occurred during 2012 and key factors that we expect will drive our future performance. This discussion refers to the Consolidated Financial Statements (Statements) and the Related Notes to Consolidated Financial Statements (Notes). This discussion should be read in conjunction with such Statements and Notes.

OVERVIEW OF 2012 AND FUTURE OUTLOOK

2012 Overview

During 2012, our financial results continued to be adversely impacted by lower prices for electricity and natural gas in the markets we serve. Electricity prices remained low due to a combination of a slow recovery in demand growth and sustained low natural gas prices. The slow economic recovery negatively impacts utility sales, and the wholesale energy and capacity markets in which we operate. The continued decline in wholesale natural gas prices resulting from greater supply from shale production has further contributed to the steady decline in the wholesale price of electricity.

In the face of reduced pricing and lower demand for electricity, we continued to pursue our three-pronged strategy of operational excellence, financial strength and disciplined investment. Our focus has been to change the business mix of our operations with increased investments in our regulated utility. Through our regulated utility operations, we secured higher and more stable transmission revenues in 2012 resulting from our annual transmission formula rate update filing with the Federal Energy Regulatory Commission (FERC) and made additional solar and energy efficiency investments in New Jersey, on which we receive contemporaneous returns. Through allocating capital to transmission and distribution infrastructure projects, we were able to take advantage of a low interest rate environment and tap into an available labor pool in the region, while enhancing the reliability of our service to our customers. Additionally, these sources of revenue allowed us to partially offset the impact of lower prices for electricity and natural gas, while the reduction in supply costs allows us to continue to invest in infrastructure improvements without raising our utility customers' rates.

While we have been successfully increasing our regulated utility earnings, we have not fully compensated for the reduction in generation earnings. Over the past few years, we experienced a decline in wholesale energy prices. Basic Generation Service (BGS) rates also declined, resulting in lower revenues for our generation business. As BGS rates reached a level closer to current spot market prices, customer migration away from BGS supply contracts continued in 2012, but at a slower pace as there was less incentive to switch to third party suppliers.

In addition, at year-end we were severely impacted by Superstorm Sandy, which resulted in the highest level of customer outages in our history. We sustained significant damage to some of our generation, transmission and distribution facilities. We received an order from the New Jersey Board of Public Utilities (BPU) allowing us to defer incurred, uninsured, incremental storm restoration costs associated with our gas and electric distribution systems.

As of December 31, 2012, Power had incurred approximately $85 million in costs related to Superstorm Sandy, primarily comprised of repairs at certain generating stations and damage to materials and supplies, both at our fossil fleet. All the costs were recognized in Operation and Maintenance Expense, offset by $19 million of a pending future recovery of insurance proceeds. Power estimates that it will incur additional future costs primarily relating to repairs to, and replacement of, equipment and property up to approximately $215 million.

As of December 31, 2012, PSE&G had incurred approximately $295 million of costs to restore service to PSE&G's distribution and transmission systems and $5 million to repair its infrastructure and return it to pre-storm conditions. Of the costs incurred, approximately $40 million was recognized in Operation and Maintenance Expense, $75 million was recorded as Property, Plant and Equipment and $180 million was recorded as a Regulatory Asset because such costs were deferred as approved by the BPU under an Order received in December 2012. PSE&G recognized $6 million of insurance proceeds.

We are working with our insurance carriers with regard to other losses and expenses due to the storm but no assurances can be given relative to the timing or amount of insurance recovery. For additional information on the impacts of Superstorm Sandy, see Item 8. Financial Statements and Supplementary Data-Note 13. Commitments and Contingent Liabilities.

There have also been significant regulatory and legislative developments during the year which may affect our operations and financial results in the future as new rules and regulations are developed. Competitive wholesale power market design is of particular importance to our results. Through litigation and the regulatory processes, we advocated for policies and rules in response to subsidized generation and procurement activities in New Jersey in connection with the Long-Term Capacity Agreement Pilot Program (LCAPP), and in Maryland through the Maryland Public Service Commission's Request for Proposal. After a favorable stakeholder vote, PJM filed proposed modifications to the Minimum Offer Price Rule (MOPR) with the FERC. In February 2013, the FERC issued a deficiency letter to PJM seeking additional information regarding the proposed MOPR changes. If the FERC approves the proposal, these modifications should significantly improve the MOPR rules and appropriately reduce the ability for subsidized generation assets to artificially suppress wholesale market prices. Litigation with respect to the New Jersey LCAPP and Maryland's efforts to subsidize new generation and challenges to the BPU's implementation of LCAPP continues. See Item 1. Business, Federal Regulation, FERC - Capacity Market Issues for further information.

We continued to monitor and advocate for the development and implementation of fair and reasonable rules by the U.S. Environmental Protection Agency (EPA). The EPA is proceeding to implement its regulatory initiatives but the outcome of judicial review remains uncertain. The EPA's 316(b) rule on cooling water intake could adversely impact future nuclear and fossil operations and costs. However, we believe our generation business remains well-positioned for Clean Air Act regulations, if and when they are implemented. For additional information on the potential impacts of the 316(b) rule, see Item 8. Financial Statements and Supplementary Data-Note 13. Commitments and Contingent Liabilities.

Another regulatory development in 2012 that could have a material impact on our business are FERC rules under Order 1000, which altered the right of first refusal previously held by incumbent utilities to build all transmission within their respective service territories. We are opposing these rules in litigation and have worked with PJM to develop implementing rules that mitigate the impact of Order 1000. We cannot predict the final outcome or impact on us; however, specific implementation of Order 1000 within our service territory may expose us to competition for certain types of transmission projects, while at the same time affording us opportunities to construct transmission outside of our service territory. See Item 1. Business, Federal Regulation, FERC -Transmission Regulation.

We are making progress in addressing these challenges, but regulatory uncertainty remains a concern.

In 2012, our continued focus on operational excellence provided the foundation for our financial strength, in turn enabling us to invest in a disciplined way for growth, providing value for our customers, employees and shareholders and allowing us to best succeed in a sustained low electricity price environment. Some specific highlights in the areas of operational excellence, financial strength and disciplined investment in 2012 are discussed in more detail below.

Operational Excellence

We seek to emphasize operational performance while developing opportunities in our competitive and regulated businesses. Low commodity prices continue to stress margins, but the flexibility of our generating fleet has allowed us to take advantage of market opportunities as we remain diligent in managing costs. In 2012, we

- constructed approximately $656M million of gross plant additions to our transmission assets currently in service,
- continued to achieve high nuclear capacity factors, which averaged 91.1% for our nuclear fleet in 2012,
- improved fossil plant summer output,
- realized high combined cycle gas turbine fleet capacity utilization factors,

- optimized fleet-switching from coal to gas to improve dispatch economics,
- extended collective bargaining agreements with four of our labor unions for four years,
- implemented more efficient plant staffing,
- were awarded the 2011 National Reliability Excellence Award for “demonstrating sustained leadership, innovation and achievement in the area of electric reliability," representing the fifth time in eight years we received this recognition, and eleven straight years that we garnered the ReliabilityOne Award for the Mid-Atlantic region, and
- received other award recognition for reliability and outage response.

Financial Strength

Our financial metrics remained strong in 2012. We maintained

- a strong balance sheet and operating cash flow,
- substantial liquidity resources, including total credit capacity of $4.3 billion and $379 million of cash on hand as of December 31, 2012, with a portion of available credit facilities extending until 2017,
- stable credit ratings,
- dividend payments of $1.42 per share for 2012, representing a change in our dividend policy moving from a strict earnings payout based approach to one that takes into consideration the growing contribution to earnings and cash from our regulated operations and continued cash flow from our generation business, and
- a well-funded position for our pension obligation, having made a $224 million contribution to our pension plan in 2012.

We also funded our capital program with internally generated cash and external debt financing.

In addition, we entered into a closing agreement settling our dispute with the Internal Revenue Service (IRS) over certain international leveraged lease transactions with finality for all tax periods in which we realized tax deductions from these transactions. Also, we executed settlement agreements covering all audit issues for tax years 1997 through 2006, concluding ten years of open audits for us. For additional information on the IRS audit settlements, see Item 8. Financial Statements and Supplementary Data-Note 20. Income Taxes.

Disciplined Investment

We seek to invest in areas that complement our existing businesses and provide attractive risk-adjusted returns. These areas include upgrading our energy infrastructure, responding to trends in environmental protection and providing new energy supplies in domestic markets with growing demand. We also have several projects where we are investing to continue to improve our operational performance. As noted above, over the past few years, we have shifted our focus to investing at the utility. Our capital expenditure forecast includes approximately $6.1 billion in spending over the next three years, 80% of which is at PSE&G. In addition, in 2012 we:

- invested approximately $1.1 billion in transmission infrastructure projects,
- completed the Peach Bottom steam path retrofit,
- added 400 MW of additional capacity with new peaking plants in New Jersey and Connecticut,
- completed solar projects in Arizona and Delaware, with the expectation to complete an additional Arizona solar project in 2013,
- made additional investments in our Capital Infrastructure Program (CIP II) and our Energy Efficiency and Demand Response Programs, and
- obtained BPU and NJDEP approvals of the North Central Reliability transmission project.

On February 20, 2013, we filed a petition with the BPU describing $3.9 billion of improvements we recommend making to our electric and gas distribution systems over a ten year period to harden and improve resiliency for the future. In addition, we anticipate investing an additional $1.5 billion in improvements to our transmission system for the same reason. See Capital Requirements for additional information.

There is no guarantee that our projects currently underway or any future initiatives will be achieved since many issues need to be favorably resolved, such as regulatory approvals. Delays in the construction schedules of our projects could impact their costs as well as the timing of expected revenues.

Future Outlook

Our future success will depend on our ability to continue to maintain strong operational and financial performance in a difficult economy and cost-constrained environment and to respond to the issues and challenges described below and take advantage of these and other regulatory and legislative initiatives. In order to do this, we must continue to:

- focus on controlling costs while maintaining our safety, reliability and compliance standards,
- successfully re-contract our open supply positions,
- execute our capital investment program, including investments for growth that yield contemporaneous and attractive risk-adjusted returns while enhancing the reliability of the service we provide to our customers,
- advocate for measures to ensure the implementation by PJM and FERC of market design rules that continue to protect competition and achieve appropriate RPM and BGS pricing, and
- reach out to and engage multiple stakeholders, including regulators, government officials, customers and investors.

For 2013 and beyond, the key issues and challenges we expect our business to confront include

- the continuing potential for sustained lower natural gas and electricity prices, both at market hubs and at locations where we operate,
- challenges to competitive markets, including support for subsidized generation in many states, particularly in New Jersey,
- customer migration away from our BGS supply contracts,
- uncertainty in the national and regional economic recovery and continuing customer conservation efforts, which impact customer demand,
- regulatory and political uncertainty, particularly with regard to future energy policy, design of energy and capacity markets, transmission policy and environmental regulation,
- the aftermath of Hurricane Irene and Superstorm Sandy, including addressing the BPU's review of performance and communications, as well as cost recovery and opportunities for investment in system strengthening and improvements,
- compressed margins and reduced utilization at coal plants,
- uncertain pension expenses and funding requirements given market volatility,
- liquidating the remaining portfolio of non-core assets where possible, while managing risk,
- monitoring financially stressed power plant leveraged lease investments, and
- successfully managing the transition to our operation of Long Island Power Authority's (LIPA) transmission and distribution system.

RESULTS OF OPERATIONS

	Years Ended December 31,		
	2012	2011	2010
Earnings (Losses)	Millions		
Power (A)	$ 647	$ 1,002	$ 1,136
PSE&G (A) (B)	528	521	359
Energy Holdings (C)	86	(134)	49
Other (D)	14	18	13
PSEG Income from Continuing Operations	**1,275**	**1,407**	**1,557**
Income (Loss) from Discontinued Operations, Including Gain on Disposal (E)	—	96	7
PSEG Net Income	**$ 1,275**	**$ 1,503**	**$ 1,564**

	Years Ended December 31,		
Earnings Per Share (Diluted)	2012	2011	2010
PSEG Income from Continuing Operations	**$ 2.51**	**$ 2.77**	**$ 3.07**
Income from Discontinued Operations, Including Gain on Disposal (E)	—	0.19	0.01
PSEG Net Income	**$ 2.51**	**$ 2.96**	**$ 3.08**

(A) Power's and PSE&G's results in 2012 include after-tax expenses of $39 million and $24 million, respectively, for Operation and Maintenance (O&M) costs due to severe damage caused by Superstorm Sandy. See Item 8. Financial Statements and Supplementary Data—Note 13. Commitments and Contingencies.

(B) PSE&G's results in 2010 include an after-tax charge of $72 million related to an agreement to refund previous Market Transition Charge (MTC) collections in the succeeding two years.

(C) Energy Holdings' results include an after-tax charge of $170 million taken in 2011 related to the reserve for assets underlying a leveraged lease receivable. See Item 8. Financial Statements and Supplementary Data—Note 8. Financing Receivables.

(D) Other includes parent company interest and financing costs, donations, certain administrative and general expenses.

(E) See Item 8. Financial Statements and Supplementary Data—Note 4. Discontinued Operations and Dispositions.

The 2012 year-over-year decrease in our Income from Continuing Operations was driven by the following:

- lower average pricing and volumes for electricity sold under our BGS contracts,
- lower average prices realized on generation sold into various power pools,
- unfavorable amounts related to the MTM activity, discussed below,
- higher Operation and Maintenance costs due to severe damage caused by Superstorm Sandy to our transmission and distribution system throughout our service territory as well as to some of our generation infrastructure in the northern part of New Jersey.

The decreases were partially offset by:

- the absence of the $170 million after-tax charge taken in 2011 on leveraged leases related to Dynegy and the settlement proceeds received in 2012 (see Item 8. Financial Statements and Supplementary Data—Note 8. Financing Receivables), and
- higher transmission revenues at PSE&G.

The 2011 year-over-year decrease in our Income from Continuing Operations was driven by the following:

- the $170 million after-tax charge on leveraged leases related to Dynegy,
- the absence of an after-tax charge of $72 million related to an agreement to refund previous MTC collections in the succeeding two years,
- lower average pricing and volumes for electricity sold under our BGS contracts,
- lower realized prices and/or lower sales volumes in the various power pools,
- higher interest costs and depreciation expense related to the completion of installation of back-end technology at two of our fossil plants, and
- the absence of realized gains recognized in 2010 due to restructuring of the investments in our Rabbi Trust.

The decreases were partially offset by:

- favorable amounts related to the MTM activity reported below,
- an increase in revenues from new wholesale contracts entered into in the first half of 2011, and
- lower Operation and Maintenance costs primarily due to lower pension and OPEB costs.

Our results include the realized gains, losses and earnings on Power's Nuclear Decommissioning Trust (NDT) Fund and other related NDT activity. Net realized gains, interest and dividend income and other costs related to the NDT Fund are recorded in Other Income and Deductions, and impairments on certain NDT securities are recorded as Other-Than-Temporary Impairments. Interest accretion expense on Power's nuclear Asset Retirement Obligation (ARO) is recorded in Operation and Maintenance Expense, as well as the depreciation related to the ARO asset. In September 2012, we restructured a portion of our NDT Fund and realized gains of $59 million. The investments were transitioned to new investment managers.

Our results also include the after-tax impacts of non-trading mark-to-market (MTM) activity, which consist of the financial impact from positions with forward delivery dates.

The combined after-tax impact on Income from Continuing Operations for the years ended December 31, 2012, 2011 and 2010 include the changes related to NDT Fund and MTM activity shown in the chart below:

Years Ended December 31,	2012	2011	2010
		Millions, after tax	
NDT Fund and Related Activity	$ 52	$ 50	$ 46
Non-Trading MTM Gains (Losses)	$ (10)	$ 107	$ (1)

PSEG

Our results of operations are primarily comprised of the results of operations of our operating subsidiaries, Power, PSE&G and Energy Holdings, excluding charges related to intercompany transactions, which are eliminated in consolidation. We also include certain financing costs, charitable contributions and general and administrative costs at the parent company. For additional information on intercompany transactions, see Item 8. Financial Statements and Supplementary Data—Note 23. Related-Party Transactions.

	Years Ended December 31,			Increase / (Decrease) 2012 vs. 2011		Increase / (Decrease) 2011 vs. 2010	
	2012	2011	2010				
	Millions			Millions	%	Millions	%
Operating Revenues	$ 9,781	$ 11,079	$ 11,793	$ (1,298)	(12)	$ (714)	(6)
Energy Costs	3,719	4,747	5,261	(1,028)	(22)	(514)	(10)
Operation and Maintenance	2,632	2,481	2,504	151	6	(23)	(1)
Depreciation and Amortization	1,054	976	955	78	8	21	2
Income from Equity Method Investments	12	4	4	8	N/A	—	—
Other Income and (Deductions)	162	135	158	27	20	(23)	(15)
Other-Than-Temporary Impairments	18	22	11	(4)	(18)	11	100
Interest Expense	423	475	472	(52)	(11)	3	1
Income Tax Expense	736	977	1,059	(241)	(25)	(82)	(8)
Income from Discontinued Operations, including Gain on Disposal, net of tax	—	96	7	(96)	(100)	89	N/A

For a detailed explanation of the variances, see the discussions for Power, PSE&G and Energy Holdings below.

Power

	Years Ended December 31,			Increase/ (Decrease) 2012 vs. 2011	Increase/ (Decrease) 2011 vs. 2010
	2012	2011	2010		
	Millions				
Income from Continuing Operations	$ 647	$ 1,002	$ 1,136	$ (355)	$ (134)
Income (Loss) from Discontinued Operations, net of tax	—	96	7	(96)	89
Net Income	$ 647	$ 1,098	$ 1,143	$ (451)	$ (45)

The 2012 year-over-year decrease in Income from Continuing Operations was driven by the following:

- lower average prices realized on generation sold into the PJM and New York (NY) power pools and MTM losses due from the realization of prior year unrealized gains and adverse changes in unrealized prices in 2012 for forward positions,
- lower average pricing and lower volumes of electricity sold under our BGS contracts, net of lower cost to serve,
- lower volumes on wholesale load contracts in PJM, lower operating reserve, ancillary and Reliability Must Run (RMR) revenues primarily in PJM and New England,
- lower average pricing and volumes of gas sold under our BGSS contracts, net of lower cost to serve, and
- higher Operation and Maintenance Expense due to damage to our generation infrastructure, primarily our fossil fleet, from Superstorm Sandy and higher refueling and maintenance costs at our nuclear plants.

These decreases were partially offset by

- lower planned outages and maintenance costs in 2012 at certain of our fossil plants, and

- lower interest expense due to the maturity of Senior Notes in April 2011 and the early redemption of Senior Notes in December 2011.

For the year ended December 31, 2011, the primary reasons for the decrease in Income from Continuing Operations were

- lower average pricing and lower volumes of electricity sold under our BGS contracts, as a result of customer migration,
- higher Operation and Maintenance expense related to planned outage work at certain of our fossil plants, and
- higher depreciation expense related to the completion of installation of back-end technology at two of our fossil plants.

The decreases were partially offset by

- favorable amounts related to the MTM activity,
- favorable results from our coal optimization efforts, and
- an increase from new wholesale contracts entered into in the first half of 2011.

The year-over-year detail for these variances for these periods is discussed below:

Power	Years Ended December 31, 2012	2011	2010	Increase / (Decrease) 2012 vs. 2011		Increase / (Decrease) 2011 vs. 2010	
	Millions			Millions	%	Millions	%
Operating Revenues	$ 4,865	$ 6,143	$ 6,558	$ (1,278)	(21)	$ (415)	(6)
Energy Costs	2,383	3,046	3,374	(663)	(22)	(328)	(10)
Operation and Maintenance	1,122	1,102	1,046	20	2	56	5
Depreciation and Amortization	237	224	175	13	6	49	28
Other Income (Deductions)	109	111	117	(2)	(2)	(6)	(5)
Other-Than-Temporary Impairments	18	20	9	(2)	(10)	11	N/A
Interest Expense	134	175	157	(41)	(23)	18	11
Income Tax Expense	433	685	778	(252)	(37)	(93)	(12)
Income (Loss) from Discontinued Operations	—	96	7	(96)	(100)	89	N/A

Year ended December 31, 2012 as compared to 2011

Operating Revenues decreased $1,278 million due to

Generation Revenues decreased $975 million due primarily to

- lower net revenues of $564 million due primarily to lower average realized prices for our generation sold into the PJM and NY power pools and MTM losses due from the realization of prior year unrealized gains and adverse changes in unrealized prices in 2012 for forward positions,
- a decrease of $264 million due primarily to lower average pricing and lower volumes of electricity sold under our BGS contracts, primarily as a result of warmer winter weather in 2012 as well as customer migration, and
- a net decrease of $154 million due to lower volumes on wholesale load contracts in the PJM and New England (NE) regions,
- partially offset by a net increase of $7 million in other revenues consisting of higher net capacity revenues, partially offset by lower operating reserve, ancillary and RMR revenues.

Gas Supply Revenues decreased $336 million due primarily to

- a decrease of $306 million in sales under the BGSS contract, substantially comprised of lower average gas prices on lower volumes of sales in 2012 due to warmer average temperatures during the first quarter of 2012, and
- a net decrease of $31 million due primarily to lower average prices, partially offset by higher sales volumes to third party customers.

Trading Revenues increased $33 million in 2012 due to the discontinuation of trading activities in the second quarter of 2011. As a result, the increase is due primarily to the absence of losses on electric energy supply contracts recognized in 2011.

Operating Expenses

Energy Costs represent the cost of generation, which includes fuel costs for generation as well as purchased energy in the market, and gas purchases to meet Power's obligation under its BGSS contract with PSE&G. Energy Costs decreased $663 million due to

- ***Gas costs*** decreased $312 million, principally related to obligations under the BGSS contract, reflecting lower average gas inventory costs coupled with lower sales volumes in 2012 due primarily to warmer average temperatures during the first quarter of 2012.
- ***Generation costs*** decreased $351 million due primarily to $227 million of lower fuel costs, reflecting the utilization of lower volumes of coal and lower average natural gas prices, partially offset by the utilization of higher volumes of natural gas and higher nuclear fuel prices in 2012. The decrease was also attributable to $152 million of lower energy purchases, primarily in the PJM region as a result of lower load contract volumes in 2012, and $31 million of lower emission charges due to lower coal generation in the PJM and NE regions and impairment charges recorded in 2011 related to excess SO_2 emission allowances. These decreases were partially offset by an increase of $59 million due primarily to higher congestion costs in the PJM region.

Operation and Maintenance increased $20 million due primarily to

- an increase of $85 million due to damage from Superstorm Sandy for repairs to certain of our generation plants, primarily those in our fossil fleet, and to recognize the estimated loss of use of fossil materials and supplies, partially offset by a $19 million insurance recovery, and
- a net increase of $64 million due to higher refueling costs in 2012 for refueling outages at our 100%-owned Hope Creek nuclear unit and our 57%-owned Salem Unit 2 as compared to refueling outages for both of our 57%-owned Salem nuclear units in 2011,
- partially offset by a net decrease of $109 million largely due to lower fossil planned outages in 2012 and lower maintenance costs, principally at our gas-fired Bethlehem Energy Center (BEC) in New York, gas-fired Bergen and Linden facilities, coal/gas-fired Hudson and Mercer coal/gas-fired plants in New Jersey, and 23%-owned coal-fired Conemaugh plant in Pennsylvania, as well as to the absence of costs incurred for the cancellation and renegotiation of a major contractual agreement for parts and services in 2011.

Depreciation and Amortization increased $13 million due primarily to higher depreciable asset bases at Fossil and Nuclear, including placing into service the new gas-fired peaking units at Kearny, New Jersey and New Haven, Connecticut on June 1, 2012 and completion of the steam path retrofit upgrades at our co-owned Peach Bottom Units 2 and 3 in October 2012 and October 2011, respectively.

Other Income (Deductions) experienced no material change.

Other-Than-Temporary Impairments decreased $2 million due to lower impairments in 2012 on the NDT and Rabbi Trust Funds.

Interest Expense decreased $41 million due primarily to a decrease of $55 million resulting primarily from the maturity of $606 million of 7.75% Senior Notes in early April 2011 and the early redemption of $600 million of 6.95% Senior Notes in December 2011, partially offset by increases of $12 million due to two $250 million Senior Notes issuances in September 2011 and $3 million in higher interest costs since interest capitalization ceased for our Kearny and New Haven projects on their June 1, 2012 in-service date.

Income Tax Expense decreased $252 million in 2012 due primarily to lower pre-tax income.

Income (Loss) from Discontinued Operations

In 2011, we sold our two 1,000 MW combined-cycle generating facilities in Texas in separate transactions. In March 2011, we completed the sale of one plant for proceeds of $352 million at an after-tax gain of $54 million. In July 2011, we completed the sale of the second plant for proceeds of $335 million at an after-tax gain of $25 million. The results of operations for both plants for 2011 and 2010, including the gains in 2011 on the sales of the plants, are included in this category. See Item 8. Financial Statements and Supplementary Data—Note 4. Discontinued Operations and Dispositions for additional information.

Year ended December 31, 2011 as compared to 2010

Operating Revenues decreased $415 million due to

Gas Supply Revenues decreased $290 million due primarily to

- a net decrease of $283 million in sales under the BGSS contract, substantially comprised of lower average gas prices on lower volumes of sales in 2011 due to warmer average temperatures during the fourth quarter of 2011,
- a net decrease of $7 million due primarily to lower average gas prices partially offset by higher sales volumes to third party customers.

Generation Revenues decreased $143 million due primarily to

- a net decrease of $305 million due primarily to lower average pricing and lower volumes of electricity sold under our BGS contracts as a result of customer migration,
- a decrease of $70 million due primarily to lower capacity payments from the various power pools resulting from lower market prices, and
- a decrease of $8 million due to lower operating reserve revenue in 2011.

These were partially offset by

- an increase of $136 million from new wholesale load contracts in the PJM and NE regions commencing in January 2011 and April 2011, respectively, net of lower average realized prices in the NE region, and
- higher net revenues of $108 million due primarily to MTM gains on economic hedging activity of $228 million, partially offset by lower realized prices in the PJM and NY power pools and lower volumes of generation sold in the PJM and NE power pools of $120 million.

Trading Revenues increased $18 million due primarily to lower net losses in 2011 on certain electric energy supply contracts as well as the discontinuation of trading activities in the second quarter of 2011.

Operating Expenses

Energy Costs represent the cost of generation, which includes fuel purchases for generation as well as purchased energy in the market, and gas purchases to meet Power’s obligation under its BGSS contract with PSE&G. Energy Costs decreased $328 million due to

- Gas costs decreased $282 million, principally related to obligations under the BGSS contract, reflecting lower average gas inventory costs coupled with lower sales volumes in 2011 due to warmer average temperatures during the fourth quarter of 2011.
- Generation costs decreased by $46 million due primarily to $211 million of lower fuel costs, including $251 million of lower fossil fuel costs primarily reflecting the utilization of lower volumes of both coal and oil, favorable results from our coal optimization efforts, and lower natural gas prices, partially offset by higher MTM losses and higher nuclear fuel costs in 2011. The decrease was also attributable to $16 million of lower emission charges, including $10 million of lower impairment charges related to excess SO_2 emission allowances. These decreases were partially offset by an increase of $153 million in higher energy purchases in 2011 in the PJM and NE power pools as the result of lower generation and the need to meet higher load contract demand in 2011 and $23 million of higher operating reserve obligations in the PJM region.

Operation and Maintenance increased $56 million due primarily to

- a net increase of $47 million due largely to planned outage costs, including hot gas path inspection outage costs at our BEC and Linden facilities as well as higher outage costs at our Bergen, and Keystone facilities, partially offset by higher outage and repair costs at certain of our other fossil plants in 2010,
- $20 million of costs incurred for the cancellation and renegotiation of a major contractual agreement for parts and services for our combined cycle Bethlehem Energy (BEC) facility in New York and Linden and Bergen facilities in New Jersey, and

- a net increase of $3 million due to refurbishment projects at our Salem nuclear facilities,
- partially offset by a decrease of $13 million due to a decrease in pension and OPEB costs tempered by higher labor costs and incentive awards.

Depreciation and Amortization increased $49 million due primarily to

- a $37 million increase due to completion of installation of back-end technology at the end of 2010 at our Mercer and Hudson generating facilities, and
- a $12 million increase due to higher depreciable asset bases at Nuclear and Fossil.

Other Income and (Deductions) The net decrease of $6 million was due primarily to

- a $17 million premium paid on the early extinguishment of 6.95% Senior Notes due in June 2012, and
- the absence of $7 million of gains realized in 2010 from restructuring the Rabbi Trust,
- partially offset by higher net realized gains of $19 million on our NDT Fund.

Other-Than-Temporary Impairments increased $11 million due primarily to higher impairments on the NDT Fund in 2011.

Interest Expense increased $18 million due primarily to

- Higher interest expense of $49 million resulting primarily from the installation by year-end 2010 of back-end technology at our Mercer and Hudson stations for which we had been allowed to capitalize interest costs in 2010 while such projects were under construction,
- partially offset by lower interest expense of $30 million due primarily to the redemption of $606 million of 7.75% Senior Notes in early April 2011 and lower debt issuance costs of $3 million.

Income Tax Expense decreased $93 million in 2011 due primarily to lower pre-tax income.

Income (Loss) from Discontinued Operations

See explanation above for year ended December 31, 2012 as compared to 2011.

PSE&G

	Years Ended December 31, 2012	2011	2010	Increase 2012 vs. 2011	Increase 2011 vs. 2010
	Millions				
Income from Continuing Operations	$ 528	$ 521	$ 359	$ 7	$ 162
Net Income	$ 528	$ 521	$ 359	$ 7	$ 162

For the year ended December 31, 2012, the primary reasons for the increase in Income from Continuing Operations were

- higher transmission revenues due to increased investments in transmission projects, and
- tax benefits related to settlement of IRS audits,
- partially offset by higher Operation and Maintenance expense, including higher storm costs and higher pension and OPEB expenses.

For the year ended December 31, 2011, the primary reasons for the increase in Income from Continuing Operations were

- the absence of a $72 million after-tax charge recorded in June 2010 related to the refund of previous MTC collections,
- higher annualized base rates for electric and gas delivery as well as transmission, and
- lower Operation and Maintenance expense, largely due to lower pension and OPEB expenses.

The year-over-year details for these variances for these periods are discussed below:

PSE&G	Years Ended December 31, 2012	2011	2010	Increase / (Decrease) 2012 vs. 2011		Increase / (Decrease) 2011 vs. 2010	
	Millions			Millions	%	Millions	%
Operating Revenues	$ 6,626	$ 7,326	$ 7,869	$ (700)	(10)	$ (543)	(7)
Energy Costs	3,159	3,951	4,655	(792)	(20)	(704)	(15)
Operation and Maintenance	1,508	1,372	1,442	136	10	(70)	(5)
Depreciation and Amortization	778	719	750	59	8	(31)	(4)
Taxes Other Than Income Taxes	98	133	136	(35)	(26)	(3)	(2)
Other Income (Deductions)	47	21	23	26	N/A	(2)	(9)
Other-Than-Temporary Impairments	—	1	—	(1)	(100)	1	100
Interest Expense	295	310	318	(15)	(5)	(8)	(3)
Income Tax Expense	307	340	232	(33)	(10)	108	47

Year ended December 31, 2012 as compared to 2011

Operating Revenues decreased $700 million due primarily to

Commodity Revenue decreased $792 million due to lower Electric and Gas revenues. This is entirely offset as savings in Energy Costs. PSE&G earns no margin on the provision of BGS and BGSS to retail customers.

- Electric revenues decreased $488 million due primarily to $431 million in lower BGS revenues and $57 million in lower revenues from the sale of Non-Utility Generation (NUG) energy and collections of Non-Utility Generation Charges (NGC) due primarily to lower prices. BGS sales decreased 12% due primarily to customer migration to third party suppliers (TPS); in contrast, delivery sales decreased only 1%.
- Gas revenues decreased $304 million due to lower BGSS volumes of $115 million and lower BGSS prices of $189 million. The average price of natural gas was 15% lower in 2012 than in 2011.

Delivery Revenues increased $81 million due primarily to an increase in transmission revenues.

- Transmission revenues were $83 million higher due to increased investments in transmission projects.
- Electric distribution revenues decreased $6 million due primarily to lower Transitional Energy Facilities Assessment (TEFA) revenue of $22 million due to a lower TEFA rate and lower sales volumes of $13 million, partially offset by higher Solar, Energy Efficiency and Conservation Program (Solar/EE) revenue of $20 million and higher Capital Infrastructure Program (CIP) revenue of $9 million.
- Gas distribution revenues increased $4 million due primarily to higher Weather Normalization Clause (WNC) revenue of $52 million and higher CIP revenue of $8 million, partially offset by lower sales volumes of $43 million, and lower TEFA revenue of $13 million due to a lower TEFA rate.

Clause Revenues increased $12 million due primarily to higher Securitization Transition Charge (STC) revenues of $19 million, partially offset by lower Societal Benefit Charges (SBC) of $6 million and a lower Margin Adjustment Clause (MAC) of $2 million. The changes in STC and SBC amounts were entirely offset by the amortization of related costs (Regulatory Assets) in O&M, Depreciation and Amortization and Interest Expense. PSE&G does not earn margin on SBC, MAC or STC collections.

Energy Costs decreased $792 million. This is entirely offset by Commodity Revenue.

- Electric costs decreased $488 million or 18% due to $258 million in lower BGS and NUG volumes, $202 million of lower BGS prices, and $28 million for decreased deferred cost recovery. BGS and NUG volumes decreased 10% due primarily to customer migration to TPS.
- Gas costs decreased $304 million or 24% due to $115 million or 9% in lower sales volumes due primarily to weather and $189 million or 15% in lower prices.

Operation and Maintenance increased $136 million, of which the most significant components were

- a $32 million increase in costs recognized related to SBC, Solar/EE and CIP,
- a $27 million increase in pension and other postretirement benefits (OPEB) expenses,
- a $17 million increase in storm damages,
- a $10 million increase in transmission related costs, and
- a $7 million increase in payroll costs.

Depreciation and Amortization increased $59 million due primarily to

- a $39 million increase in amortization of Regulatory Assets, and
- a $21 million increase in additional plant in service.

Taxes Other Than Income Taxes decreased $35 million due to a lower TEFA rate and lower sales volumes for electric and gas.

Other Income and (Deductions) net increase of $26 million was due primarily to

- a $14 million increase in capitalized allowance for equity funds used during construction,
- an $8 million increase in solar loan interest income, and
- a $4 million increase in Rabbi Trust interest and gains.

Other-Than-Temporary Impairments experienced no material change.

Interest Expense decreased $15 million due primarily to the partial redemption of securitization debt and higher interest capitalization related to higher construction work in progress, partially offset by interest relating to the new debt issued in 2012. See Note 9. Changes in Capitalization for details.

Income Tax Expense decreased $33 million due primarily to changes in tax reserves related to settlement of IRS tax audits.

Year ended December 31, 2011 as compared to 2010

Operating Revenues decreased $543 million due primarily to

Commodity Revenue decreased $704 million due to lower Electric and Gas revenues. This is entirely offset as savings in Energy Costs. PSE&G earns no margin on the provision of BGS and BGSS.

- Electric revenues decreased $397 million due primarily to $466 million in lower BGS revenues, partially offset by $69 million in higher revenues from the sale of NUG energy and collections of NGC due primarily to higher prices. BGS sales decreased 16% due primarily to customer migration to TPS; in contrast, delivery sales decreased only 2%.
- Gas revenues decreased $307 million due to lower BGSS prices of $259 million and lower BGSS volumes of $48 million. The average price of gas was 3% lower in 2011 than in 2010.

Delivery Revenues increased $74 million due primarily to an increase in prices for electric and gas distribution and transmission.

- Transmission revenues were $42 million higher due primarily to increased investments in transmission projects.
- Gas distribution revenues increased $32 million due primarily to higher WNC revenue of $19 million and the impact of base rate increases of $17 million, partially offset by lower CIP revenue of $5 million.
- Electric distribution revenues were flat due primarily to the impact of base rate increases of $17 million and higher CIP revenue of $1 million, offset by lower sales volumes of $18 million.

Clause Revenues increased $73 million due primarily to the absence of $122 million charge recorded in June 2010 related to our agreement to refund previous MTC collections over two years and higher SBC and MAC of $49 million, partially offset by lower STC revenues of $98 million. The changes in STC, SBC and MAC amounts were entirely offset by the amortization of related costs (Regulatory Assets) in O&M, Depreciation and Amortization and Interest Expense. PSE&G earns no margins on SBC, STC or MAC collections.

Other Operating Revenues increased $14 million due primarily to increased revenues from our appliance repair business and miscellaneous electric operating revenues.

Energy Costs decreased $704 million. This is entirely offset by Commodity Revenue.

- Electric costs decreased $397 million due to $405 million in lower BGS and NUG volumes and $75 million of lower BGS and NUG prices, partially offset by $83 million for increased deferred cost recovery. BGS and NUG volumes decreased 14% due primarily to customer migration to TPS.
- Gas costs decreased $307 million or 19% due to $259 million or 16% in lower prices and $48 million or 3% in lower sales volumes due primarily to weather.

Operation and Maintenance decreased $70 million due primarily to

- a $71 million decrease in pension and OPEB expenses,
- $20 million of lower net deferred expenses associated with SBC, Regional Greenhouse Gas Initiative and Stimulus clauses, and
- the absence of $15 million in expenses relating to 2010 rate case disallowances.

These were partially offset by

- a $9 million increase in storm restoration work,
- a $6 million increase in costs relating to tree trimming,
- a $3 million increase in bad debt expense, and
- a $3 million increase in incentive payments.

Depreciation and Amortization decreased $31 million due primarily to

- a decrease of $63 million for amortization of Regulatory Assets,
- partially offset by an increase of $28 million for additional plant in service, and an increase of $3 million in net other charges.

Other Income and (Deductions) experienced no material change.

Other-Than-Temporary Impairments experienced no material change.

Interest Expense decreased $8 million due primarily to lower average debt balances.

Income Tax Expense increased $108 million due primarily to higher pre-tax income.

Energy Holdings

	Years Ended December 31,			Increase/ (Decrease)	Increase/ (Decrease)
	2012	2011	2010	2012 vs. 2011	2011 vs. 2010
	Millions				
Income from Continuing Operations	$ 86	$ (134)	$ 49	$ 220	$ (183)
Net Income	$ 86	$ (134)	$ 49	$ 220	$ (183)

For the year ended December 31, 2012, the primary reasons for the increase in Income from Continuing Operations were

- the absence of the $170 million after-tax charge on leveraged leases related to Dynegy in 2011 and the settlement proceeds received in 2012 (see Item 8. Financial Statements and Supplementary Data—Note 8. Financing Receivables), and
- the tax benefits related to the settlement of IRS tax audits in the first quarter of 2012.

For the year ended December 31, 2011, the primary reason for the decrease in Income from Continuing Operations was

- the $170 million after-tax charge on leveraged leases related to Dynegy.

LIQUIDITY AND CAPITAL RESOURCES

The following discussion of our liquidity and capital resources is on a consolidated basis, noting the uses and contributions, where material, of our three direct operating subsidiaries.

Financing Methodology

We expect our capital requirements to be met through internally generated cash flows and external financings, consisting of short-term debt for working capital needs and long-term debt for capital investments.

PSE&G's sources of external liquidity include a $600 million multi-year syndicated credit facility. PSE&G's commercial paper program is the primary vehicle for meeting seasonal, intra-month and temporary working capital needs. PSE&G does not engage in any intercompany borrowing or lending. PSE&G maintains back-up facilities in an amount sufficient to cover 100% of commercial paper outstanding. PSE&G's dividend payments to PSEG are consistent with its capital structure objectives which have been established to maintain investment grade credit ratings. PSE&G's long-term financing plan is designed to replace maturities, fund a portion of its capital program and manage short-term debt balances. Generally, PSE&G uses either secured medium-term notes or first mortgage bonds to raise long-term capital.

PSEG, Power, Energy Holdings and PSEG Services Corporation participate in a corporate money pool, an aggregation of daily cash balances designed to efficiently manage their respective short-term liquidity needs. PSEG's sources of external liquidity include multi-year syndicated credit facilities totaling $1 billion. These facilities are available to back-stop PSEG's commercial paper program, issue letters of credit and for general corporate purposes. These facilities may also be used to provide support to PSEG's subsidiaries. PSEG's credit facilities and the commercial paper program are available to support PSEG working capital needs or to temporarily fund growth opportunities in advance of obtaining permanent financing. From time to time, PSEG may make equity contributions or provide credit support to its subsidiaries.

Power's sources of external liquidity include $2.7 billion of syndicated multi-year credit facilities. Additionally, from time to time, Power maintains bilateral credit agreements designed to enhance its liquidity position. Credit capacity is primarily used to provide collateral in support of hedging activities and to meet potential collateral postings in the event of a credit rating downgrade below investment grade. Power's dividend payments to PSEG are also designed to be consistent with its capital structure objectives which have been established to maintain investment grade credit ratings and provide sufficient financial flexibility. Generally, Power issues senior unsecured debt to raise long-term capital.

Operating Cash Flows

We expect our operating cash flows combined with cash on hand and financing activities to be sufficient to fund capital expenditures and shareholder dividend payments.

For the year ended December 31, 2012, our operating cash flow decreased by $770 million. For the year ended December 31, 2011, our operating cash flow increased by $1,393 million. The net changes were due to net changes from our subsidiaries as discussed below.

Power

Power's operating cash flow decreased $433 million from $1,812 million to $1,379 million for the year ended December 31, 2012, as compared to 2011, primarily resulting from lower earnings and a $173 million decrease from lower net collections of counterparty receivables, partially offset by

- a decrease of $57 million in benefit plan funding,
- a $73 million decrease in spending for fuel, materials and supplies, and
- a $246 million decrease in net payment of counterparty payables.

Power's operating cash flow increased $246 million from $1,566 million to $1,812 million for the year ended December 31, 2011, as compared to 2010, primarily resulting from

- an increase of $368 million due to lower tax payments, primarily related to the benefits of accelerated tax depreciation under new tax provisions enacted in 2010 (see Item 8. Financial Statements and Supplementary Data—Note 20. Income Taxes for additional information), and
- a $302 million increase from net collection of counterparty receivables.

These were partially offset by

- a $171 million increase in net payment of counterparty payables,

- a $161 million net increase in spending on fuel inventories, and
- lower earnings.

PSE&G

PSE&G's operating cash flow decreased $520 million from $1,776 million to $1,256 million for the year ended December 31, 2012, as compared to 2011, due primarily to

- a lower tax receipt of $484 million due to lower benefit of accelerated tax depreciation, and
- a decrease of $306 million due to lower collections from customer billings,
- partially offset by a decrease of $117 million in benefit plan funding, and
- a decrease of $88 million in net prepayments due primarily to the application of prior year prepayment carryforwards towards current year state tax liabilities.

PSE&G's operating cash flow increased $765 million from $1,011 million to $1,776 million for the year ended December 31, 2011, as compared to 2010, due primarily to higher earnings combined with

- an increase of $587 million due to lower tax payments, primarily related to the benefits of accelerated tax depreciation under new tax provisions enacted in 2010 (see Item 8. Financial Statements and Supplementary Data—Note 20. Income Taxes for additional information), and
- an increase of $273 million due to higher collections of customer billings,
- partially offset by a decrease of $108 million in net other working capital.

Energy Holdings

Energy Holdings' operating cash flow increased $149 million for the year ended December 31, 2012, as compared to 2011, primarily due to lower tax payments in 2012 related to the absence of lease sale activity in 2012 and tax benefits related to settlement of IRS audits.

Energy Holdings' operating cash flow increased $341 million for the year ended December 31, 2011, as compared to 2010, primarily due to lower tax payments in 2011 related to less lease sale activity in 2011.

Short-Term Liquidity

We continually monitor our liquidity and seek to add capacity as needed to meet our liquidity requirements. Each of our credit facilities is restricted as to availability and use to the specific companies as listed below; however, if necessary, the PSEG facilities can also be used to support our subsidiaries' liquidity needs. Our total credit facilities and available liquidity as of December 31, 2012 were as follows:

	As of December 31, 2012		
Company/Facility	**Total Facility**	**Usage**	**Available Liquidity**
		Millions	
PSEG	$ 1,000	$ 4	$ 996
Power	2,700	165	2,535
PSE&G	600	276	324
Total	**$ 4,300**	**$ 445**	**$ 3,855**

As of December 31, 2012, our credit facility capacity is in excess of our projected maximum liquidity requirements over our 12 month planning horizon. Our maximum liquidity requirements are based on stress scenarios that incorporate changes in commodity prices and the potential impact of Power losing its investment grade credit rating. PSE&G's credit facility primary use is to support its Commercial Paper Program under which as of December 31, 2012, $263 million was outstanding. For additional information, see Item 8. Financial Statements and Supplementary Data—Note 13. Commitments and Contingent Liabilities and Note 14. Schedule of Consolidated Debt.

Long-Term Debt Financing

PSE&G had $150 million of 5.00% Medium Term Notes mature in January 2013 and issued $400 million of 3.80% Secured Medium-Term Notes, Series H, due January, 2043. PSE&G also has $300 million of 5.38% Medium Term Notes maturing in September 2013 and $275 million of 6.33% Medium Term Notes maturing in November 2013. Power has $300 million of 2.50% Senior Notes maturing in April 2013.

For a discussion of our long-term debt transactions during 2012 and into 2013, see Item 8. Financial Statements and Supplementary Data—Note 14. Schedule of Consolidated Debt.

Debt Covenants

Our credit agreements contain maximum debt to equity ratios and other restrictive covenants and conditions to borrowing. We are currently in compliance with all of our debt covenants. Continued compliance with applicable financial covenants will depend upon our future financial position, level of earnings and cash flows, as to which no assurances can be given.

In addition, under its First and Refunding Mortgage (Mortgage), PSE&G may issue new First and Refunding Mortgage Bonds against previous additions and improvements, provided that its ratio of earnings to fixed charges calculated in accordance with its Mortgage is at least 2 to 1, and/or against retired Mortgage Bonds. As of December 31, 2012, PSE&G's Mortgage coverage ratio was 3.6 to 1 and the Mortgage would permit up to approximately $2.6 billion aggregate principal amount of new Mortgage Bonds to be issued against additions and improvements to its property.

Default Provisions

Our bank credit agreements and indentures contain various default provisions that could result in the potential acceleration of payment under the defaulting company's agreement. We have not defaulted under these agreements.

PSEG's bank credit agreements contain cross default provisions under which events at Power or PSE&G, including payment defaults, bankruptcy events, the failure to satisfy certain final judgments or other events of default under their financing agreements, would each constitute an event of default. Under the bank credit agreements, it would be an event of default if both Power and PSE&G cease to be wholly owned by PSEG.

There are no cross default provisions to affiliates in Power's or PSE&G's credit agreements or indentures.

Ratings Triggers

Our debt indentures and credit agreements do not contain any material 'ratings triggers' that would cause an acceleration of the required interest and principal payments in the event of a ratings downgrade. However, in the event of a downgrade, any one or more of the affected companies may be subject to increased interest costs on certain bank debt and certain collateral requirements. In the event that we are not able to affirm representations and warranties on credit agreements, lenders would not be required to make loans.

Fluctuations in commodity prices or a deterioration of Power's credit rating to below investment grade could increase Power's required margin postings under various agreements entered into in the normal course of business. Power believes it has sufficient liquidity to meet the required posting of collateral which would likely result from a credit rating downgrade at today's market prices.

In accordance with BPU requirements under the BGS contracts, PSE&G is required to maintain an investment grade credit rating. If PSE&G were to lose its investment grade rating, it would be required to file a plan to assure continued payment for the BGS requirements of its customers.

PSE&G is the servicer for the bonds issued by PSE&G Transition Funding LLC and PSE&G Transition Funding II LLC. Cash collected by PSE&G to service these bonds is commingled with PSE&G's other cash until it is remitted to the bond trustee each month. If PSE&G were to lose its investment grade rating, PSE&G would be required to remit collected cash daily to the bond trustee. PSE&G is prohibited from advancing its own funds to make payments related to such bonds.

Common Stock Dividends

Dividend Payments on Common Stock	Years Ended December 31, 2012	2011	2010
Per Share	$ 1.42	$ 1.37	$ 1.37
in Millions	$ 718	$ 693	$ 693

In 2012, dividend payments increased from $1.37 per share to $1.42 per share, representing a change in our dividend policy, moving from a strict earnings payout based approach to one that takes into consideration the growing contribution to earnings and cash from our regulated operations and continued cash flow from our generation business.

On February 19, 2013, our Board of Directors approved a $0.36 per share common stock dividend for the first quarter of 2013. This reflects an indicated annual dividend rate of $1.44 per share. We expect to continue to pay cash dividends on our common stock; however, the declaration and payment of future dividends to holders of our common stock will be at the discretion of the Board of Directors and will depend upon many factors, including our financial condition, earnings, capital requirements of our businesses, alternate investment opportunities, legal requirements, regulatory constraints, industry practice and other factors that the Board of Directors deems relevant.

Credit Ratings

If the rating agencies lower or withdraw our credit ratings, such revisions may adversely affect the market price of our securities and serve to materially increase our cost of capital and limit access to capital. Outlooks assigned to ratings are as follows: stable, negative (Neg) or positive (Pos). There is no assurance that the ratings will continue for any given period of time or that they will not be revised by the rating agencies, if, in their respective judgments, circumstances warrant. Each rating given by an agency should be evaluated independently of the other agencies' ratings. The ratings should not be construed as an indication to buy, hold or sell any security.

In May 2012, Moody's published updated credit opinions on PSEG, Power and PSE&G. Moody's upgraded PSE&G's Mortgage Bond Rating to A1 from A2 and revised the outlook to stable from positive. PSEG's and Power's ratings and outlooks remained unchanged. In October 2012, S&P published updated credit opinions that left the ratings and outlooks for Power and PSE&G unchanged. In November 2012, S&P published an updated credit opinion for PSEG that left its ratings and outlook unchanged. In July 2012, Fitch upgraded PSE&G's Mortgage Bond Rating to A+ from A and its stable outlook remained unchanged. In January 2013, Fitch published updated credit opinions on PSEG, Power and PSE&G. PSEG's, Power's and PSE&G's ratings and outlooks remained unchanged.

	Moody's (A)	S&P (B)	Fitch (C)
PSEG			
Outlook	**Stable**	**Positive**	**Stable**
Commercial Paper	P2	A2	F2
Power			
Outlook	**Stable**	**Positive**	**Stable**
Senior Notes	Baa1	BBB	BBB+
PSE&G			
Outlook	**Stable**	**Positive**	**Stable**
Mortgage Bonds	A1	A-	A+
Commercial Paper	P2	A2	F2

(A) Moody's ratings range from Aaa (highest) to C (lowest) for long-term securities and P1 (highest) to NP (lowest) for short-term securities.
(B) S&P ratings range from AAA (highest) to D (lowest) for long-term securities and A1 (highest) to D (lowest) for short-term securities.
(C) Fitch ratings range from AAA (highest) to D (lowest) for long-term securities and F1 (highest) to D (lowest) for short-term securities.

Other Comprehensive Loss

For the year ended December 31, 2012, we had Other Comprehensive Loss of $51 million on a consolidated basis. Other Comprehensive Loss was due primarily to a $46 million increase in our consolidated liability for pension and postretirement benefits and $24 million of unrealized losses on derivative contracts accounted for as hedges and was partially offset by $19 million of net unrealized gains related to Available-for-Sale Securities.

CAPITAL REQUIREMENTS

It is expected that all of our capital requirements over the next three years will come from a combination of internally generated funds and external debt financing. Projected capital construction and investment expenditures, excluding nuclear fuel purchases, for the next three years are presented in the table below. These amounts are subject to change, based on various factors. We will continue to approach non-regulated solar and other renewables investments opportunistically, seeking projects that will provide attractive risk-adjusted returns for our shareholders.

	2013	2014	2015
Power:		Millions	
Baseline Maintenance	$ 215	$ 170	$ 200
Environmental/Regulatory	70	70	15
Nuclear Expansion	115	125	90
Total Power	**$ 400**	**$ 365**	**$ 305**
PSE&G:			
Transmission			
Reliability Enhancements	$ 1,230	$ 1,040	$ 550
Facility Replacement	265	145	160
Support Facilities	10	15	10
Environmental/Regulatory	5	—	—
Distribution			
Reliability Enhancements	85	75	75
Facility Replacement	140	150	175
Support Facilities	45	50	45
New Business	125	130	135
Environmental/Regulatory	35	35	30
Renewables	100	40	—
Total PSE&G	**$ 2,040**	**$ 1,680**	**$ 1,180**
Non-Utility Renewables	50	—	—
Other	45	40	30
Total PSEG	**$ 2,535**	**$ 2,085**	**$ 1,515**

Power

Power's projected expenditures for the various items listed above are primarily comprised of the following:

- Baseline Maintenance—investments to replace major parts and enhance operational performance.
- Environmental/Regulatory—investments made in response to environmental, regulatory or legal mandates.
- Nuclear Expansion—investments associated with various capital projects at existing facilities to either extend plants' useful lives or increase operating output.

In 2012, Power made $438 million of capital expenditures, including interest capitalized during construction (IDC) but excluding $208 million for nuclear fuel, primarily related to various projects at Fossil and Nuclear.

PSE&G

PSE&G's projections for future capital expenditures include material additions and replacements to its transmission and distribution systems to meet expected growth and to manage reliability. As project scope and cost estimates develop, PSE&G will modify its current projections to include these required investments. PSE&G's projected expenditures for the various items reported above are primarily comprised of the following:

- Reliability Enhancements—investments made to improve the reliability and efficiency of the system or function.
- Facility Replacement—investments made to replace systems or equipment in kind.
- Support Facilities—ancillary equipment needed to support the business lines, such as computers, office furniture and buildings and structures housing support personnel or equipment/inventory.
- New Business—investments made in support of new business (e.g. to add new customers).
- Environmental/Regulatory—investments made in response to environmental, regulatory or legal mandates.
- Renewables—investments made in response to regulatory or legal mandates relating to renewable energy.

In 2012, PSE&G made $1,852 million of capital expenditures, including $1,770 million of investment in plant, primarily for transmission and distribution system reliability and $82 million in solar loan investments. This does not include expenditures for certain energy efficiency and renewable programs of $8 million or cost of removal, net of salvage, of $116 million, which are included in operating cash flows.

Additional Projects

The estimated project expenditures related to the following filings or transmission infrastructure investments are not included in our $6.1 billion three-year capital forecast table.

In February 2013, we filed a petition with the BPU describing the improvements we recommend making to our electric and gas distribution systems over a ten year period to harden and improve resiliency for the future. In this petition, we sought approval to invest $0.9 billion in our gas distribution system and $1.7 billion in our electric distribution over an initial five year period, plus associated expenses, and to receive contemporaneous recovery of and on such investments. This matter is pending. The current estimated cost of the entire program, including the first five years of investments for which we sought approval in this petition, is $3.9 billion. We anticipate seeking BPU approval to complete our investment under the program at a later date. We also intend to invest $1.5 billion in FERC jurisdictional investments in transmission infrastructure over the next ten years.

In July 2012, we filed for an extension of our Solar 4 All program. In this filing, we are seeking BPU approval for up to $690 million to develop 136 MW of utility-owned solar photovoltaic systems over a five year period starting in 2013. Consistent with the existing Solar 4 All program, we propose to sell the energy and capacity from the solar systems in the PJM wholesale energy and capacity markets which will offset the cost of the program.

We also filed for an additional extension of our Solar Loan program (Solar Loan III) in July 2012. In the filing, we are seeking BPU approval to provide financing support for the installation of 97.5 MW of solar systems by providing loans to qualified customers. The total investment of the proposed Solar Loan III program is anticipated to be up to $193 million once the program is fully subscribed, projects are built and loans are closed.

Disclosures about Long-Term Maturities, Contractual and Commercial Obligations and Certain Investments

The following table reflects our contractual cash obligations and other commercial commitments in the respective periods in which they are due. See Item 8. Financial Statements and Supplementary Data -Note 13. Commitments and Contingent Liabilities for a discussion of contractual commitments related to the construction activity, discussed above, and for a variety of services for which annual amounts are not quantifiable. In addition, the table summarizes anticipated recourse and non-recourse debt maturities for the years shown. For additional information, see Item 8. Financial Statements and Supplementary Data—Note 14. Schedule of Consolidated Debt. The table below does not reflect any anticipated cash payments for pension obligations due to uncertain timing of payments or liabilities for uncertain tax positions since we are unable to reasonably estimate the timing of liability payments in individual years beyond 12 months due to uncertainties in the timing of the effective settlement of tax positions. See Item 8. Financial Statements and Supplementary Data—Note 20. Income Taxes for additional information.

	Total Amount Committed	Less Than 1 Year	2 - 3 Years	4- 5 Years	Over 5 Years
			Millions		
Contractual Cash Obligations					
Long-Term Recourse Debt Maturities					
Power	$ 2,353	$ 300	$ 344	$ 553	$ 1,156
PSE&G	4,804	725	800	171	3,108
Transition Funding (PSE&G)	690	214	476	—	—
Transition Funding II (PSE&G)	32	12	20	—	—
Long-Term Non-Recourse Project Financing					
Energy Holdings	44	1	18	8	17
Interest on Recourse Debt					
Power	1,194	118	228	172	676
PSE&G	3,370	224	356	314	2,476
Transition Funding (PSE&G)	80	42	38	—	—
Transition Funding II (PSE&G)	2	1	1	—	—
Interest on Non-Recourse Project Financing					
Energy Holdings	12	2	4	3	3
Capital Lease Obligations					
PSEG	20	7	13	—	—
Power	5	2	3	—	—
Operating Leases					
PSEG	214	—	3	25	186
Power	8	—	2	2	4
PSE&G	54	7	9	6	32
Energy Holdings	21	2	4	3	12
Energy-Related Purchase Commitments					
Power	2,796	667	1,133	811	185
Total Contractual Cash Obligations	**$ 15,699**	**$ 2,324**	**$ 3,452**	**$ 2,068**	**$ 7,855**
Commercial Commitments					
Standby Letters of Credit					
Power	$ 214	$ 169	$ 45	$ —	$ —
PSE&G	13	13	—	—	—
Guarantees and Equity Commitments					
Energy Holdings	53	53	—	—	—
Total Commercial Commitments	**$ 280**	**$ 235**	**$ 45**	**$ —**	**$ —**
Liability Payments for Uncertain Tax Positions					
PSEG	$ —	$ —	$ —	$ —	$ —
Power	5	5	—	—	—
PSE&G	—	—	—	—	—
Energy Holdings	70	70	—	—	—

OFF-BALANCE SHEET ARRANGEMENTS

Power

Power issues guarantees in conjunction with certain of its energy contracts. See Item 8. Financial Statements and Supplementary Data—Note 13. Commitments and Contingent Liabilities for further discussion.

Energy Holdings

We have certain investments that are accounted for under the equity method in accordance with GAAP. Accordingly, amounts recorded on the Consolidated Balance Sheets for such investments represent our equity investment, which is increased for our pro-rata share of earnings less any dividend distribution from such investments. One of the companies in which we invest that is accounted for under the equity method has an aggregate $28 million of long-term debt on its Consolidated Balance Sheet. Our pro-rata share of such debt is $14 million. This debt is non-recourse to us. We are generally not required to support the debt service obligations of this company. However, default with respect to this non-recourse debt could result in a loss of invested equity.

Through Energy Holdings, we have investments in leveraged leases that are accounted for in accordance with GAAP Accounting for Leases. Leveraged lease investments generally involve three parties: an owner/lessor, a creditor and a lessee. In a typical leveraged lease arrangement, the lessor purchases an asset to be leased. The purchase price is typically financed 80% with debt provided by the creditor and the balance comes from equity funds provided by the lessor. The creditor provides long-term financing to the transaction secured by the property subject to the lease. Such long-term financing is non-recourse to the lessor and is not presented on our Consolidated Balance Sheets. In the event of default, the leased asset, and in some cases the lessee, secures the loan. As a lessor, Energy Holdings has ownership rights to the property and rents the property to the lessees for use in their business operations. For additional information, see Item 8. Financial Statements and Supplementary Data—Note 7. Long-Term Investments.

In the event that collectability of the minimum lease payments to be received by Energy Holdings is no longer reasonably assured, the accounting treatment for some of the leases may change. In such cases, Energy Holdings may deem that a lessee has a high probability of defaulting on the lease obligation, and would reclassify the lease from a leveraged lease to an operating lease and would consider the need to record an impairment of its investment. Should this event occur, the fair value of the underlying asset and the associated debt would be recorded on the Consolidated Balance Sheets instead of the net equity investment in the lease.

CRITICAL ACCOUNTING ESTIMATES

Under GAAP, many accounting standards require the use of estimates, variable inputs and assumptions (collectively referred to as estimates) that are subjective in nature. Because of this, differences between the actual measure realized versus the estimate can have a material impact on results of operations, financial position and cash flows. We have determined that the following estimates are considered critical to the application of rules that relate to the respective businesses.

Accounting for Pensions

We calculate pension costs using various economic and demographic assumptions.

***Assumptions and Approach Used*:** Economic assumptions include the discount rate and the long-term rate of return on trust assets. Demographic assumptions include projections of future mortality rates, pay increases and retirement patterns.

Assumption	2012	2011	2010
Discount Rate	4.20%	5.00%	5.51%
Rate of Return on Plan Assets	8.00%	8.50%	8.50%

Our discount rate assumption, which is determined annually, is based on the rates of return on high-quality fixed-income investments currently available and expected to be available during the period to maturity of the pension benefits. The discount rate used to calculate pension obligations is determined as of December 31 each year, our measurement date. The discount rate used to determine year-end obligations is also used to develop the following year's net periodic pension cost.

Our expected rate of return on plan assets reflects current asset allocations, historical long-term investment performance and an estimate of future long-term returns by asset class and long-term inflation assumptions.

Based on the above assumptions, we have estimated net periodic pension expense of approximately $110 million, net of amounts capitalized, and contributions of up to $145 million in 2013.

***Effect if Different Assumptions Used*:** As part of the business planning process, we have modeled future costs assuming an 8.00% rate of return and a 4.20% discount rate for 2013, a 4.50% discount rate for 2014, increasing annually by 25 basis points to 5.25% in 2017. Actual future pension expense and funding levels will depend on future investment performance, changes in discount rates, market conditions, funding levels relative to our projected benefit obligation and accumulated benefit obligation and various other factors related to the populations participating in the pension plans.

The following chart reflects the sensitivities associated with a change in certain assumptions. The effects of the assumption changes shown below solely reflect the impact of that specific assumption.

Assumption	% Change	Impact on Pension Benefit Obligation As of December 31, 2012	Increase to Pension Expense in 2013
		Millions	
Discount Rate	(1)%	$ 751	$ 72
Rate of Return on Plan Assets	(1)%	$ —	$ 44

See Item 7A. Quantitative and Qualitative Disclosures About Market Risk for additional information.

Hedge and MTM Accounting

Current guidance requires us to recognize the fair value of derivative instruments, not designated as normal purchases or normal sales, at their fair value on the balance sheet. Many non-trading contracts qualify for normal purchases and normal sales exemption and are accounted for upon settlement.

***Assumptions and Approach Used*:** In general, the fair value of our derivative instruments is determined by reference to quoted market prices from contracts listed on exchanges or from brokers. Some of these derivative contracts are long-term and rely on forward price quotations over the entire duration of the derivative contracts.

For a small number of contracts where quoted market prices are not available, we utilize mathematical models that rely on historical data to develop forward pricing information in the determination of fair value. Because the determination of fair value using such models is subject to significant assumptions and estimates, we developed reserve policies that are consistently applied to model-generated results to determine reasonable estimates of the fair value to record in the financial statements.

We have entered into various derivative instruments to manage risk from changes in commodity prices and interest rates. In accordance with our hedging strategy, derivatives that are hedging these risks and qualify are designated as either cash flow hedges or fair value hedges. For derivatives designated as hedges, the change in the value of a derivative instrument is measured against the offsetting change in the value of the underlying contract, anticipated transaction or other business condition that the derivative instrument is intended to hedge. This is known as the measure of hedge effectiveness. Changes in the fair value of the effective portion of a derivative instrument designated as a fair value hedge, along with changes in the fair value of the hedged asset or liability that are attributable to the hedged risk, are recorded in current period earnings. Changes in the fair value of the effective portion of derivative instruments designated as cash flow hedges, are reported in Accumulated Other Comprehensive Income (Loss), net of tax, until earnings are affected by the variability of cash flows of the hedged transaction. Any hedge ineffectiveness is included in current period earnings. During periods of extreme price volatility, there will be significant changes in the value recorded in Accumulated Other Comprehensive Income (Loss).

For our wholesale energy business, many of the forward sale, forward purchase, option and other contracts are derivative instruments that hedge commodity price risk, but do not meet the requirements for either cash flow or fair value hedge accounting. The changes in value of such derivative contracts are marked to market through earnings as the related commodity prices fluctuate. As a result, our earnings may experience significant fluctuations depending on the volatility of commodity prices.

***Effect if Different Assumptions Used*:** Any significant changes to the fair market values of our derivatives instruments could result in a material change in the value of the assets or liabilities recorded on our Consolidated Balance Sheets and could result in a material change to the unrealized gains or losses recorded in our Consolidated Statements of Operations.

For additional information regarding Derivative Financial Instruments, see Item 8. Financial Statements and Supplementary Data—Note 16. Financial Risk Management Activities.

Lease Investments

Our Investments in Leases, included in Long-Term Investments on our Consolidated Balance Sheets, are comprised of Lease Receivables (net of non-recourse debt), the estimated residual value of leased assets, and unearned and deferred income. A significant portion of the estimated residual value of leased assets is related to merchant power plants leased to other energy companies. See Item 8. Financial Statements and Supplementary Data – Note 7. Long-Term Investments, and Note 8. Financing Receivables.

Assumptions and Approach Used: Residual values are the estimated values of the leased assets at the end of the respective lease terms. The estimated values are calculated by discounting the cash flows related to the leased assets after the lease term. For the merchant power plants, the estimated discounted cash flows are dependent upon various assumptions, including:

- estimated forward power and capacity prices in the years after the lease,
- related prices of fuel for the plants,
- dispatch rates for the plants,
- future capital expenditures required to maintain the plants,
- future operation and maintenance expenses, and
- discount rates.

Residual valuations are performed annually for each plant subject to lease using specific assumptions tailored to each plant. Those annual valuations are compared to the recorded residual values to determine if an impairment is warranted.

Effect if Different Assumptions Used: A significant change to the assumptions, such as a large decrease in near-term power prices that affects the market's view of long-term power prices, or a change in the credit rating or bankruptcy of a counterparty, could result in an impairment of one or more of the residual values, but not necessarily to all of the residual values. However, if, because of changes in assumptions, all the residual values related to the merchant energy plants were deemed to be zero, we would recognize an after-tax charge to income of approximately $177 million.

NDT Fund

Our NDT Fund is comprised of both debt and equity securities. The assets in the NDT Fund are classified as available-for-sale securities and are marked to market with unrealized gains and losses recorded in Accumulated Other Comprehensive Income (Loss) unless securities with such unrealized losses are deemed to be other-than-temporarily-impaired. Realized gains, losses and dividend and interest income are recorded in our Consolidated Statements of Operations as Other Income and Other Deductions. Unrealized losses that are deemed to be other-than-temporarily impaired are charged against earnings rather than Accumulated Other Comprehensive Income (Loss) and reflected as a separate line in the Consolidated Statement of Operations.

***Assumptions and Approach Used*:** The NDT Fund investments are valued using quoted market prices, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency. See Item 8. Financial Statements and Supplementary Data—Note 17. Fair Value Measurements for additional information.

***Effect if Different Assumptions Used*:** Any significant changes to the fair market values of the fund securities could result in a material change in the value of our NDT Fund with a corresponding impact to earnings, which could potentially result in additional funding requirements to satisfy our decommissioning obligations. See Item 7A. Quantitative and Qualitative Disclosures About Market Risk for additional information.

Asset Retirement Obligations (ARO)

Power, PSE&G and Services recognize liabilities for the expected cost of retiring long-lived assets for which a legal obligation exists. These AROs are recorded at fair value in the period in which they are incurred and are capitalized as part of the carrying amount of the related long-lived assets. PSE&G, as a rate-regulated entity, recognizes regulatory assets or liabilities as a result of timing differences between the recording of costs and costs recovered through the ratemaking process. We accrete the ARO liability to reflect the passage of time.

Assumptions and Approach Used: Because quoted market prices are not available for AROs, we estimate the initial fair value of an ARO by calculating discounted cash flows that are dependent upon various assumptions, including:

- estimation of dates for retirement,
- amounts and timing of future cash expenditures associated with retirement, settlement or remediation activities,

- discount rates,
- cost escalation rates,
- market risk premium,
- inflation rates, and
- if applicable, past experience with government regulators regarding similar obligations.

We obtain updated cost studies every three years unless new information necessitates more frequent updates. The most recent cost study was done in 2012. When we revise any assumptions used to calculate fair values of existing AROs, we adjust the ARO balance and corresponding long-lived asset which impacts the amount of accretion and depreciation expense recognized in future periods.

Nuclear Decommissioning AROs

AROs related to the future decommissioning of Power’s nuclear facilities comprised 94% of Power’s total AROs as of December 31, 2012. Power determines its AROs for its nuclear units by assigning probability weighting to various discounted cash flow outcomes for each of its nuclear units that incorporate the assumptions above as well as:

- license renewals,
- early shutdown,
- safe storage for a period of time after retirement, and
- recovery from the federal government of costs incurred for spent nuclear fuel.

Effect if Different Assumptions Used: Changes in the assumptions could result in a material change in the ARO balance sheet obligation and the period over which we accrete to the ultimate liability. For example, a 1% decrease in the discount rate used at December 31, 2012 would result in a $134 million increase in the Nuclear ARO as of December 31, 2012. A 1% increase in the inflation rate used at December 31, 2012 would result in a $335 million increase in the Nuclear ARO as of December 31, 2012. Also, if we did not assume that we would recover from the federal government the costs incurred for spent nuclear fuel, the Nuclear ARO would increase by $273 million at December 31, 2012.

Accounting for Regulated Businesses

PSE&G prepares its financial statements to comply with GAAP for rate-regulated enterprises, which differs in some respects from accounting for non-regulated businesses. In general, accounting for rate-regulated enterprises should reflect the economic effects of regulation. As a result, a regulated utility is required to defer the recognition of costs (Regulatory Asset) or recognize obligations (Regulatory Liability) if the rates established are designed to recover the costs and if the competitive environment makes it probable that such rates can be charged or collected. This accounting results in the recognition of revenues and expenses in different time periods than that of enterprises that are not regulated.

Assumptions and Approach Used: PSE&G recognizes Regulatory Assets where it is probable that such costs will be recoverable in future rates from customers and Regulatory Liabilities where it is probable that refunds will be made to customers in future billings. The highest degree of probability is an order from the BPU either approving recovery of the deferred costs over a future period or requiring the refund of a liability over a future period.

Virtually all of PSE&G’s regulatory assets and liabilities are supported by BPU orders. In the absence of an order, PSE&G will consider the following when determining whether to record a Regulatory Asset or Liability:

- past experience regarding similar items with the BPU,
- treatment of a similar item in an order by the BPU for another utility,
- passage of new legislation, and
- recent discussions with the BPU.

All deferred costs are subject to prudence reviews by the BPU. When the recovery of a Regulatory asset or payment of a Regulatory Liability is no longer probable, PSE&G charges or credits earnings, as appropriate.

***Effect if Different Assumptions Used*:** A change in the above assumptions may result in a material impact on our results of operations or our cash flows. See Item 8. Financial Statements and Supplementary Data—Note 6. Regulatory Assets and Liabilities for a description of the amounts and nature of regulatory balance sheet amounts.

Accounting for Insurance Proceeds

In late October 2012, Superstorm Sandy caused severe damage to our transmission and distribution system as well as to some of our generation infrastructure in the northern part of New Jersey. Strong winds resulted in a storm surge that caused damage to switching stations, substations and generating infrastructure. We are in the early stages of gathering information needed in preparing an insurance claim relating to that damage. As of December 31, 2012, we recorded estimated insurance proceeds of $25 million ($19 million for Power and $6 million for PSE&G). See Item 8. Financial Statements and Supplementary Data—Note 13. Commitments and Contingencies for additional information.

Assumptions and Approach Used: In December 2012, we received correspondence from representatives of the various insurance carriers acknowledging that damages were sustained and authorizing $25 million in advance payments to be made to us. Based on that authorization, we recorded the estimated insurance proceeds of $25 million. We believe that any further proceeds to be received under our policies are not estimable at December 31, 2012. We are at the early stages of documenting our insurance claim which then needs to be submitted to, and reviewed by, the insurers. We believe we have no basis for developing an estimate for any further insurance recoveries at this time.

Effect if Different Assumptions Used: If we were to use different assumptions regarding additional insurance proceeds, there would be a dollar for dollar effect on Operation and Maintenance Expense and Operating Income for Power. If we were to recognize any additional insurance proceeds for PSE&G, we would allocate those proceeds between Operation and Maintenance Expense and costs that have been deferred for regulatory recovery or capitalized. In either case, we would not recognize insurance proceeds in excess of actual costs incurred.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The market risk inherent in our market-risk sensitive instruments and positions is the potential loss arising from adverse changes in commodity prices, equity security prices and interest rates as discussed in the Notes to Consolidated Financial Statements. It is our policy to use derivatives to manage risk consistent with business plans and prudent practices. We have a Risk Management Committee comprised of executive officers who utilize a risk oversight function to ensure compliance with our corporate policies and risk management practices.

Additionally, we are exposed to counterparty credit losses in the event of non-performance or non-payment. We have a credit management process, which is used to assess, monitor and mitigate counterparty exposure. In the event of non-performance or non-payment by a major counterparty, there may be a material adverse impact on our financial condition, results of operations or net cash flows.

Commodity Contracts

The availability and price of energy-related commodities are subject to fluctuations from factors such as weather, environmental policies, changes in supply and demand, state and federal regulatory policies, market rules and other events. To reduce price risk caused by market fluctuations, we enter into supply contracts and derivative contracts, including forwards, futures, swaps and options with approved counterparties. These contracts, in conjunction with physical sales and other services, help reduce risk and optimize the value of owned electric generation capacity.

Value-at-Risk (VaR) Models

VaR represents the potential losses, under normal market conditions, for instruments or portfolios due to changes in market factors, for a specified time period and confidence level. We estimate VaR across our commodity businesses.

MTM VaR consists of MTM derivatives that are economic hedges, some of which qualify for hedge accounting. The MTM VaR calculation does not include market risks associated with activities that are subject to accrual accounting, primarily our generating facilities and some load serving activities.

The VaR models used are variance/covariance models adjusted for the change of positions with 95% and 99.5% confidence levels and a one-day holding period for the MTM activities. The models assume no new positions throughout the holding periods; however, we actively manage our portfolio.

Year Ended December 31, 2012		MTM VaR (A)
		Millions
95% Confidence Level,		
Loss could exceed VaR one day in 20 days		
Period End	$	18
Average for the Period	$	16
High	$	29
Low	$	7
99.5% Confidence Level,		
Loss could exceed VaR one day in 200 days		
Period End	$	28
Average for the Period	$	25
High	$	46
Low	$	11

(A) As of December 31, 2012 and December 31, 2011, there was no trading VaR since we discontinued trading activities in the second quarter of 2011.

See Item 8. Financial Statements and Supplementary Data—Note 16. Financial Risk Management Activities for a discussion of credit risk.

Interest Rates

We are subject to the risk of fluctuating interest rates in the normal course of business. We manage interest rate risk by targeting a balanced debt maturity profile which limits refinancing in any given period or interest rate environment. In addition, we use a mix of fixed and floating rate debt, interest rate swaps and interest rate lock agreements.

As of December 31, 2012, a hypothetical 10% increase in market interest rates would result in

- less than $1 million of additional annual interest costs related to both the current and long-term portion of long-term debt, and
- a $223 million decrease in the fair value of debt, including a $56 million decrease at Power and a $166 million decrease at PSE&G.

Debt and Equity Securities

We have $4.6 billion of assets in our pension plan trusts. Although fluctuations in market prices of securities within this portfolio do not directly affect our earnings in the current period, changes in the value of these investments could affect

- our future contributions to these plans,
- our financial position if our accumulated benefit obligation under our pension plans exceeds the fair value of the pension trust funds, and
- future earnings, as we could be required to adjust pension expense and the assumed rate of return.

The NDT Fund is comprised of both fixed income and equity securities totaling $1.5 billion as of December 31, 2012. As of December 31, 2012, the portfolio includes $789 million of equity securities and $627 million in fixed income securities. The fair market value of the assets in the NDT Fund will fluctuate primarily depending upon the performance of equity markets. As of December 31, 2012, a hypothetical 10% change in the equity market would impact the value of the equity securities in the NDT Fund by approximately $79 million.

We use duration to measure the interest rate sensitivity of the fixed income portfolio. Duration is a summary statistic of the effective average maturity of the fixed income portfolio. The benchmark for the fixed income component of the NDT Fund currently has duration of 4.31 years and a yield of 1.24%. The portfolio's value will appreciate or depreciate by the duration with a 1% change in interest rates. As of December 31, 2012, a hypothetical 1% increase in interest rates would result in a decline in the market value for the fixed income portfolio of approximately $27 million.

Credit Risk

See Item 8. Financial Statements and Supplementary Data—Note 16. Financial Risk Management Activities for a discussion of credit risk and a discussion about Power's credit risk.

BGS suppliers expose PSE&G to credit losses in the event of non-performance or non-payment upon a default of the BGS supplier. Credit requirements are governed under BPU approved BGS contracts.

Energy Holdings has credit risk with respect to its counterparties to power purchase agreements and other parties.

Energy Holdings also has credit risk related to its investments in leases, which totaled $117 million, net of deferred taxes of $723 million, as of December 31, 2012. These leveraged leases are concentrated in the United States energy industry. See Item 8. Financial Statements and Supplementary Data -Note 8. Financing Receivables for counterparties' credit ratings and other information. The credit exposure to the lessees is partially mitigated through various credit enhancement mechanisms within the lease transactions. These credit enhancement features vary from lease to lease. Some of the leasing transactions include covenants that restrict the flow of dividends from the lessee to its parent, over-collateralization of the lessee with non-leased assets, historical and forward cash flow coverage tests that prohibit discretionary capital expenditures and dividend payments to the parent/lessee if stated minimum coverages are not met and similar cash flow restrictions if ratings are not maintained at stated levels. These covenants are designed to maintain cash reserves in the transaction entity for the benefit of the non-recourse lenders and the lessor/equity participants in the event of a temporary market downturn or degradation in operating performance of the leased assets.

In any lease transaction, in the event of a default, Energy Holdings would exercise its rights and attempt to seek recovery of its investment. The results of such efforts may not be known for a period of time. A bankruptcy of a lessee and failure to recover adequate value could lead to a foreclosure of the lease. Under a worst-case scenario, if a foreclosure were to occur, Energy Holdings would record a pre-tax write-off up to its outstanding gross investment, including deferred taxes, in these facilities. Also, in the event of a potential foreclosure, the net tax benefits generated by Energy Holdings' portfolio of investments could be materially reduced in the period in which gains associated with the potential forgiveness of debt at these projects occurs. The amount and timing of any potential reduction in net tax benefits is dependent upon a number of factors including, but not limited to, the time of a potential foreclosure, the amount of lease debt outstanding, any cash trapped at the projects and negotiations during such potential foreclosure process. The potential loss of earnings, impairment and/or tax payments could have a material impact to our financial position, results of operations and net cash flows.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

This combined Form 10-K is separately filed by PSEG, Power and PSE&G. Information contained herein relating to any individual company is filed by such company on its own behalf. Power and PSE&G each make representations only as to itself and make no representations as to any other company.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and Board of Directors of
Public Service Enterprise Group Incorporated:

We have audited the accompanying consolidated balance sheets of Public Service Enterprise Group Incorporated and subsidiaries (the "Company") as of December 31, 2012 and 2011, and the related consolidated statements of operations, comprehensive income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2012. Our audits also included the consolidated financial statement schedule listed in the Index at Item 15(B)(a). These consolidated financial statements and consolidated financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on the consolidated financial statements and consolidated financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2012 and 2011, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2012, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such consolidated financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2012, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 25, 2013 expressed an unqualified opinion on the Company's internal control over financial reporting.

/s/ DELOITTE & TOUCHE LLP

Parsippany, New Jersey
February 25, 2013

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Sole Member and Board of Directors of
PSEG Power LLC:

We have audited the accompanying consolidated balance sheets of PSEG Power LLC and subsidiaries (the "Company") as of December 31, 2012 and 2011, and the related consolidated statements of operations, comprehensive income, member's equity, and cash flows for each of the three years in the period ended December 31, 2012. Our audits also included the consolidated financial statement schedule listed in the Index at Item 15(B)(b). These consolidated financial statements and consolidated financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on the consolidated financial statements and consolidated financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2012 and 2011, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2012, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such consolidated financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

/s/ DELOITTE & TOUCHE LLP

Parsippany, New Jersey
February 25, 2013

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Sole Stockholder and Board of Directors of
Public Service Electric and Gas Company:

We have audited the accompanying consolidated balance sheets of Public Service Electric and Gas Company and subsidiaries (the "Company") as of December 31, 2012 and 2011, and the related consolidated statements of operations, comprehensive income, common stockholder's equity, and cash flows for each of the three years in the period ended December 31, 2012. Our audits also included the consolidated financial statement schedule listed in the Index at Item 15(B)(c). These consolidated financial statements and consolidated financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on the consolidated financial statements and consolidated financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2012 and 2011, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2012, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such consolidated financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

/s/ DELOITTE & TOUCHE LLP

Parsippany, New Jersey
February 25, 2013

PUBLIC SERVICE ENTERPRISE GROUP INCORPORATED
CONSOLIDATED STATEMENTS OF OPERATIONS
Millions

	Years Ended December 31, 2012	2011	2010
OPERATING REVENUES	$ 9,781	$ 11,079	$ 11,793
OPERATING EXPENSES			
Energy Costs	3,719	4,747	5,261
Operation and Maintenance	2,632	2,481	2,504
Depreciation and Amortization	1,054	976	955
Taxes Other Than Income Taxes	98	133	136
Total Operating Expenses	7,503	8,337	8,856
OPERATING INCOME	2,278	2,742	2,937
Income from Equity Method Investments	12	4	4
Other Income	260	220	221
Other Deductions	(98)	(85)	(63)
Other-Than-Temporary Impairments	(18)	(22)	(11)
Interest Expense	(423)	(475)	(472)
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	2,011	2,384	2,616
Income Tax (Expense) Benefit	(736)	(977)	(1,059)
INCOME FROM CONTINUING OPERATIONS	1,275	1,407	1,557
Income (Loss) from Discontinued Operations, including Gain on Disposal, net of tax (expense) benefit of $0, $(51) and $(8) for the years ended 2012, 2011 and 2010, respectively	—	96	7
NET INCOME	$ 1,275	$ 1,503	$ 1,564
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING (THOUSANDS):			
BASIC	505,933	505,949	505,985
DILUTED	507,086	506,982	507,045
EARNINGS PER SHARE:			
BASIC			
INCOME FROM CONTINUING OPERATIONS	$ 2.52	$ 2.78	$ 3.08
NET INCOME	$ 2.52	$ 2.97	$ 3.09
DILUTED			
INCOME FROM CONTINUING OPERATIONS	$ 2.51	$ 2.77	$ 3.07
NET INCOME	$ 2.51	$ 2.96	$ 3.08
DIVIDENDS PAID PER SHARE OF COMMON STOCK	$ 1.42	$ 1.37	$ 1.37

See Notes to Consolidated Financial Statements.

PUBLIC SERVICE ENTERPRISE GROUP INCORPORATED
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
Millions

	Years Ended December 31,		
	2012	**2011**	**2010**
NET INCOME	$ 1,275	$ 1,503	$ 1,564
Other Comprehensive Income (Loss), net of tax			
Unrealized Gains (Losses) on Available-for-Sale Securities, net of tax (expense) benefit of $(24), $43 and $(12) for the years ended 2012, 2011 and 2010, respectively	19	(39)	6
Change in Fair Value of Derivative Instruments, net of tax (expense) benefit of $(11), $(33) and $(42) for the years ended 2012, 2011 and 2010, respectively	17	47	60
Reclassification Adjustments for Net Amounts included in Net Income, net of tax (expense) benefit of $29, $87 and $90 for the years ended 2012, 2011 and 2010, respectively	(41)	(127)	(129)
Pension/OPEB adjustment, net of tax (expense) benefit of $32, $44 and $(18) for the years ended 2012, 2011 and 2010, respectively	(46)	(62)	23
Other Comprehensive Income (Loss), net of tax	(51)	(181)	(40)
COMPREHENSIVE INCOME	$ 1,224	$ 1,322	$ 1,524

See Notes to Consolidated Financial Statements.

PUBLIC SERVICE ENTERPRISE GROUP INCORPORATED
CONSOLIDATED BALANCE SHEETS
Millions

	December 31,	
	2012	2011
ASSETS		
CURRENT ASSETS		
Cash and Cash Equivalents	$ 379	$ 834
Accounts Receivable, net of allowances of $56 and $56 in 2012 and 2011, respectively	1,069	967
Tax Receivable	227	16
Unbilled Revenues	314	289
Fuel	583	685
Materials and Supplies, net	422	367
Prepayments	283	308
Derivative Contracts	138	156
Deferred Income Taxes	49	—
Regulatory Assets	349	167
Other	56	122
Total Current Assets	3,869	3,911
PROPERTY, PLANT AND EQUIPMENT	27,402	25,080
Less: Accumulated Depreciation and Amortization	(7,666)	(7,231)
Net Property, Plant and Equipment	19,736	17,849
NONCURRENT ASSETS		
Regulatory Assets	3,830	3,805
Regulatory Assets of Variable Interest Entities (VIEs)	713	925
Long-Term Investments	1,324	1,303
Nuclear Decommissioning Trust (NDT) Fund	1,540	1,349
Other Special Funds	191	172
Goodwill	16	16
Other Intangibles	34	131
Derivative Contracts	153	106
Restricted Cash of VIEs	23	22
Other	296	232
Total Noncurrent Assets	8,120	8,061
TOTAL ASSETS	$ 31,725	$ 29,821

See Notes to Consolidated Financial Statements.

PUBLIC SERVICE ENTERPRISE GROUP INCORPORATED
CONSOLIDATED BALANCE SHEETS
Millions

	December 31, 2012	December 31, 2011
LIABILITIES AND CAPITALIZATION		
CURRENT LIABILITIES		
Long-Term Debt Due Within One Year (includes $50 at fair value in 2011)	$ 1,026	$ 417
Securitization Debt of VIEs Due Within One Year	226	216
Commercial Paper and Loans	263	—
Accounts Payable	1,304	1,184
Derivative Contracts	46	131
Accrued Interest	91	97
Accrued Taxes	17	30
Deferred Income Taxes	72	170
Clean Energy Program	153	214
Obligation to Return Cash Collateral	122	107
Regulatory Liabilities	67	100
Other	390	291
Total Current Liabilities	3,777	2,957
NONCURRENT LIABILITIES		
Deferred Income Taxes and Investment Tax Credits (ITC)	6,542	5,458
Regulatory Liabilities	209	228
Regulatory Liabilities of VIEs	10	9
Asset Retirement Obligations	627	489
Other Postretirement Benefit (OPEB) Costs	1,285	1,127
Accrued Pension Costs	876	734
Clean Energy Program	—	39
Environmental Costs	537	643
Derivative Contracts	122	26
Long-Term Accrued Taxes	164	292
Other	108	86
Total Noncurrent Liabilities	10,480	9,131
COMMITMENTS AND CONTINGENT LIABILITIES (See Note 13)		
CAPITALIZATION		
LONG-TERM DEBT		
Long-Term Debt	6,148	6,694
Securitization Debt of VIEs	496	723
Project Level, Non-Recourse Debt	43	44
Total Long-Term Debt	6,687	7,461
STOCKHOLDERS' EQUITY		
Common Stock, no par, authorized 1,000,000,000 shares; issued, 2012 and 2011—533,556,660 shares	4,833	4,823
Treasury Stock, at cost, 2012—27,664,188 shares; 2011—27,611,374 shares	(607)	(601)
Retained Earnings	6,942	6,385
Accumulated Other Comprehensive Loss	(388)	(337)
Total Common Stockholders' Equity	10,780	10,270
Noncontrolling Interest	1	2
Total Stockholders' Equity	10,781	10,272
Total Capitalization	17,468	17,733
TOTAL LIABILITIES AND CAPITALIZATION	$ 31,725	$ 29,821

See Notes to Consolidated Financial Statements.

PUBLIC SERVICE ENTERPRISE GROUP INCORPORATED
CONSOLIDATED STATEMENTS OF CASH FLOWS
Millions

	Years Ended December 31, 2012	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES			
Net Income	$ 1,275	$ 1,503	$ 1,564
Adjustments to Reconcile Net Income to Net Cash Flows from Operating Activities:			
Gain on Disposal of Discontinued Operations	—	(122)	—
Depreciation and Amortization	1,054	982	974
Amortization of Nuclear Fuel	173	153	136
Provision for Deferred Income Taxes (Other than Leases) and ITC	721	811	1,106
Non-Cash Employee Benefit Plan Costs	271	175	315
Leveraged Lease Income, Adjusted for Rents Received and Deferred Taxes	93	(55)	(336)
Loss on Leases, net of tax	—	170	—
Net (Gain) Loss on Lease Investments	(49)	(55)	(56)
Net Realized and Unrealized (Gains) Losses on Energy Contracts and Other Derivatives	63	(165)	50
Deferred Storm Costs	(90)	(60)	(8)
Net Change in Regulatory Assets and Liabilities	(132)	(130)	(58)
Cost of Removal	(116)	(62)	(58)
Net Realized (Gains) Losses and (Income) Expense from NDT Fund	(118)	(117)	(106)
Net Change in Tax Receivable	(211)	673	(689)
Net Change in Certain Current Assets and Liabilities	97	247	(221)
Employee Benefit Plan Funding and Related Payments	(314)	(508)	(508)
Other	70	117	59
Net Cash Provided By (Used In) Operating Activities	2,787	3,557	2,164
CASH FLOWS FROM INVESTING ACTIVITIES			
Additions to Property, Plant and Equipment	(2,574)	(2,083)	(2,160)
Proceeds from Sale of Discontinued Operations	—	687	—
Proceeds from Sale of Capital Leases and Investments	58	179	496
Proceeds from Sales of Available-for-Sale Securities	1,666	1,355	1,116
Investments in Available-for-Sale Securities	(1,700)	(1,386)	(1,140)
Other	(75)	(21)	19
Net Cash Provided By (Used In) Investing Activities	(2,625)	(1,269)	(1,669)
CASH FLOWS FROM FINANCING ACTIVITIES			
Net Change in Commercial Paper and Loans	263	(64)	(466)
Issuance of Long-Term Debt	900	794	1,728
Redemption of Long-Term Debt, including Securitization Debt	(1,003)	(1,720)	(972)
Repayment of Non-Recourse Debt	(1)	(1)	(32)
Cash Dividend Paid on Common Stock	(718)	(693)	(693)
Redemption of Preferred Securities	—	—	(80)
Other	(58)	(50)	(50)
Net Cash Provided By (Used In) Financing Activities	(617)	(1,734)	(565)
Net Increase (Decrease) in Cash and Cash Equivalents	(455)	554	(70)
Cash and Cash Equivalents at Beginning of Period	834	280	350
Cash and Cash Equivalents at End of Period	$ 379	$ 834	$ 280
Supplemental Disclosure of Cash Flow Information:			
Income Taxes Paid (Received)	$ 121	$ (219)	$ 1,070
Interest Paid, Net of Amounts Capitalized	$ 402	$ 479	$ 444
Accrued Property, Plant and Equipment Expenditures	$ 370	$ 336	$ 235

See the Notes to Consolidated Financial Statements.

PUBLIC SERVICE ENTERPRISE GROUP INCORPORATED
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
Millions

	Common Stock		Treasury Stock					
	Shs.	**Amount**	**Shs.**	**Amount**	**Retained Earnings**	**Accumulated Other Comprehensive Income (Loss)**	**Noncontrolling Interest**	**Total**
Balance as of January 1, 2010	534	$ 4,788	(28)	$ (588)	$ 4,704	$ (116)	$ 10	$ 8,798
Net Income	—	—	—	—	1,564	—	—	1,564
Other Comprehensive Income (Loss), net of tax (expense) benefit of $18	—	—	—	—	—	(40)	—	(40)
Comprehensive Income								1,524
Cash Dividends on Common Stock	—	—	—	—	(693)	—	—	(693)
Noncontrolling Interest in Losses of Consolidated Entity	—	—	—	—	—	—	(2)	(2)
Other	—	19	—	(5)	—	—	—	14
Balance as of December 31, 2010	534	$ 4,807	(28)	$ (593)	$ 5,575	$ (156)	$ 8	$ 9,641
Net Income	—	—	—	—	1,503	—	—	1,503
Other Comprehensive Income (Loss), net of tax (expense) benefit of $141	—	—	—	—	—	(181)	—	(181)
Comprehensive Income								1,322
Cash Dividends on Common Stock	—	—	—	—	(693)	—	—	(693)
Noncontrolling Interest in Losses of Consolidated Entity	—	—	—	—	—	—	(6)	(6)
Other	—	16	—	(8)	—	—	—	8
Balance as of December 31, 2011	534	$ 4,823	(28)	$ (601)	$ 6,385	$ (337)	$ 2	$ 10,272
Net Income	—	—	—	—	1,275	—	—	1,275
Other Comprehensive Income (Loss), net of tax (expense) benefit of $26	—	—	—	—	—	(51)	—	(51)
Comprehensive Income								1,224
Cash Dividends on Common Stock	—	—	—	—	(718)	—	—	(718)
Noncontrolling Interest in Losses of Consolidated Entity	—	—	—	—	—	—	(1)	(1)
Other	—	10	—	(6)	—	—	—	4
Balance as of December 31, 2012	534	$ 4,833	(28)	$ (607)	$ 6,942	$ (388)	$ 1	$ 10,781

See Notes to Consolidated Financial Statements.

PSEG POWER LLC
CONSOLIDATED STATEMENTS OF OPERATIONS
Millions

	Years Ended December 31,		
	2012	2011	2010
OPERATING REVENUES	$ 4,865	$ 6,143	$ 6,558
OPERATING EXPENSES			
Energy Costs	2,383	3,046	3,374
Operation and Maintenance	1,122	1,102	1,046
Depreciation and Amortization	237	224	175
Total Operating Expenses	3,742	4,372	4,595
OPERATING INCOME	1,123	1,771	1,963
Other Income	199	190	170
Other Deductions	(90)	(79)	(53)
Other-Than-Temporary Impairments	(18)	(20)	(9)
Interest Expense	(134)	(175)	(157)
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	1,080	1,687	1,914
Income Tax (Expense) Benefit	(433)	(685)	(778)
INCOME FROM CONTINUING OPERATIONS	647	1,002	1,136
Income (Loss) from Discontinued Operations, including Gain on Disposal, net of tax (expense) benefit of $0, $(51) and $(8) for the years ended 2012, 2011 and 2010, respectively	—	96	7
EARNINGS AVAILABLE TO PUBLIC SERVICE ENTERPRISE GROUP INCORPORATED	$ 647	$ 1,098	$ 1,143

See disclosures regarding PSEG Power LLC included in the Notes to Consolidated Financial Statements.

PSEG POWER LLC
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
Millions

	Years Ended December 31, 2012	2011	2010
NET INCOME	$ 647	$ 1,098	$ 1,143
Other Comprehensive Income (Loss), net of tax			
Unrealized Gains (Losses) on Available-for-Sale Securities, net of tax (expense) benefit of $(24), $45 and $(17) for the years ended 2012, 2011 and 2010, respectively	18	(42)	15
Change in Fair Value of Derivative Instruments, net of tax (expense) benefit of $(11), $(33) and $(42) for the years ended 2012, 2011 and 2010, respectively	17	47	60
Reclassification Adjustments for Net Amounts included in Net Income, net of tax (expense) benefit of $29, $87, and $90 for the years ended 2012, 2011 and 2010, respectively	(41)	(127)	(129)
Pension/OPEB adjustment, net of tax (expense) benefit of $32, $40, and $(15) for the years ended 2012, 2011 and 2010, respectively	(46)	(59)	21
Other, net of tax (expense) benefit of $0 for the year ended 2010	—	—	(1)
Other Comprehensive Income (Loss), net of tax	(52)	(181)	(34)
COMPREHENSIVE INCOME	$ 595	$ 917	$ 1,109

See disclosures regarding PSEG Power LLC included in the Notes to Consolidated Financial Statements.

PSEG POWER LLC
CONSOLIDATED BALANCE SHEETS
Millions

	December 31,	
	2012	2011
ASSETS		
CURRENT ASSETS		
Cash and Cash Equivalents	$ 7	$ 12
Accounts Receivable	269	267
Accounts Receivable—Affiliated Companies, net	340	381
Short-Term Loan to Affiliate	574	907
Fuel	583	685
Materials and Supplies, net	307	272
Derivative Contracts	118	139
Prepayments	17	24
Other	19	—
Total Current Assets	2,234	2,687
PROPERTY, PLANT AND EQUIPMENT	9,697	9,191
Less: Accumulated Depreciation and Amortization	(2,679)	(2,460)
Net Property, Plant and Equipment	7,018	6,731
NONCURRENT ASSETS		
Nuclear Decommissioning Trust (NDT) Fund	1,540	1,349
Goodwill	16	16
Other Intangibles	34	131
Other Special Funds	36	33
Derivative Contracts	49	55
Other	105	85
Total Noncurrent Assets	1,780	1,669
TOTAL ASSETS	$ 11,032	$ 11,087

See disclosures regarding PSEG Power LLC included in the Notes to Consolidated Financial Statements.

PSEG POWER LLC
CONSOLIDATED BALANCE SHEETS
Millions

	December 31, 2012	December 31, 2011
LIABILITIES AND MEMBER'S EQUITY		
CURRENT LIABILITIES		
Long-Term Debt Due Within One Year	$ 300	$ 66
Accounts Payable	498	541
Derivative Contracts	46	124
Deferred Income Taxes	16	53
Accrued Interest	26	32
Other	81	86
Total Current Liabilities	967	902
NONCURRENT LIABILITIES		
Deferred Income Taxes and Investment Tax Credits (ITC)	1,575	1,266
Asset Retirement Obligations	369	259
Other Postretirement Benefit (OPEB) Costs	221	180
Derivative Contracts	15	24
Accrued Pension Costs	272	236
Long-Term Accrued Taxes	50	8
Other	84	83
Total Noncurrent Liabilities	2,586	2,056
COMMITMENTS AND CONTINGENT LIABILITIES (See Note 13)		
LONG-TERM DEBT		
Total Long-Term Debt	2,040	2,685
MEMBER'S EQUITY		
Contributed Capital	2,028	2,028
Basis Adjustment	(986)	(986)
Retained Earnings	4,725	4,678
Accumulated Other Comprehensive Loss	(328)	(276)
Total Member's Equity	5,439	5,444
TOTAL LIABILITIES AND MEMBER'S EQUITY	$ 11,032	$ 11,087

See disclosures regarding PSEG Power LLC included in the Notes to Consolidated Financial Statements.

PSEG POWER LLC
CONSOLIDATED STATEMENTS OF CASH FLOWS
Millions

	Years Ended December 31, 2012	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES			
Net Income	$ 647	$ 1,098	$ 1,143
Adjustments to Reconcile Net Income to Net Cash Flows from Operating Activities:			
Gain on Disposal of Discontinued Operations	—	(122)	—
Depreciation and Amortization	237	231	194
Amortization of Nuclear Fuel	173	153	136
Provision for Deferred Income Taxes and ITC	342	231	650
Interest Accretion on Asset Retirement Obligation	21	18	18
Net Realized and Unrealized (Gains) Losses on Energy Contracts and Other Derivatives	63	(165)	50
Non-Cash Employee Benefit Plan Costs	70	41	71
Net Realized (Gains) Losses and (Income) Expense from NDT Fund	(118)	(117)	(106)
Net Change in Certain Current Assets and Liabilities:			
Fuel, Materials and Supplies	47	(26)	135
Margin Deposit	(116)	49	(91)
Accounts Receivable	24	197	(105)
Accounts Payable	92	(154)	17
Accounts Receivable/Payable-Affiliated Companies, net	(40)	459	(386)
Accrued Interest Payable	(6)	(8)	(3)
Other Current Assets and Liabilities	(16)	38	(63)
Employee Benefit Plan Funding and Related Payments	(72)	(129)	(132)
Other	31	18	38
Net Cash Provided By (Used In) Operating Activities	1,379	1,812	1,566
CASH FLOWS FROM INVESTING ACTIVITIES			
Additions to Property, Plant and Equipment	(646)	(757)	(825)
Proceeds from Sale of Discontinued Operations	—	687	—
Proceeds from Sales of Available-for-Sale Securities	1,478	1,355	989
Investments in Available-for-Sale Securities	(1,506)	(1,380)	(1,013)
Short-Term Loan—Affiliated Company, net	333	(509)	(398)
Other	(7)	26	42
Net Cash Provided By (Used In) Investing Activities	(348)	(578)	(1,205)
CASH FLOWS FROM FINANCING ACTIVITIES			
Issuance of Recourse Long-Term Debt	—	544	594
Cash Dividend Paid	(600)	(500)	(549)
Redemption of Long-Term Debt	(414)	(1,250)	(248)
Short-Term Loan—Affiliated Company, net	—	—	(194)
Cash Payment on Debt Redemption/Exchange	(15)	(17)	(13)
Other	(7)	(10)	(4)
Net Cash Provided By (Used In) Financing Activities	(1,036)	(1,233)	(414)
Net Increase (Decrease) in Cash and Cash Equivalents	(5)	1	(53)
Cash and Cash Equivalents at Beginning of Period	12	11	64
Cash and Cash Equivalents at End of Period	$ 7	$ 12	$ 11
Supplemental Disclosure of Cash Flow Information:			
Income Taxes Paid (Received)	$ 136	$ 171	$ 539
Interest Paid, Net of Amounts Capitalized	$ 119	$ 176	$ 151
Accrued Property, Plant and Equipment Expenditures	$ 95	$ 132	$ 111

See disclosures regarding PSEG Power LLC included in the Notes to Consolidated Financial Statements.

PSEG POWER LLC
CONSOLIDATED STATEMENTS OF MEMBER'S EQUITY
Millions

	Contributed Capital	Basis Adjustment	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance as of January 1, 2010	$ 2,028	$ (986)	$ 3,486	$ (61)	$ 4,467
Net Income	—	—	1,143	—	1,143
Other Comprehensive Income (Loss), net of tax (expense) benefit of $16	—	—	—	(34)	(34)
Comprehensive Income					1,109
Cash Dividends Paid	—	—	(549)	—	(549)
Balance as of December 31, 2010	$ 2,028	$ (986)	$ 4,080	$ (95)	$ 5,027
Net Income	—	—	1,098	—	1,098
Other Comprehensive Income (Loss), net of tax (expense) benefit of $139	—	—	—	(181)	(181)
Comprehensive Income					917
Cash Dividends Paid	—	—	(500)	—	(500)
Balance as of December 31, 2011	$ 2,028	$ (986)	$ 4,678	$ (276)	$ 5,444
Net Income	—	—	647	—	647
Other Comprehensive Income (Loss), net of tax (expense) benefit of $26	—	—	—	(52)	(52)
Comprehensive Income					595
Cash Dividends Paid	—	—	(600)	—	(600)
Balance as of December 31, 2012	$ 2,028	$ (986)	$ 4,725	$ (328)	$ 5,439

See disclosures regarding PSEG Power LLC included in the Notes to Consolidated Financial Statements.

PUBLIC SERVICE ELECTRIC AND GAS COMPANY
CONSOLIDATED STATEMENTS OF OPERATIONS
Millions

	Years Ended December 31, 2012	2011	2010
OPERATING REVENUES	$ 6,626	$ 7,326	$ 7,869
OPERATING EXPENSES			
Energy Costs	3,159	3,951	4,655
Operation and Maintenance	1,508	1,372	1,442
Depreciation and Amortization	778	719	750
Taxes Other Than Income Taxes	98	133	136
Total Operating Expenses	5,543	6,175	6,983
OPERATING INCOME	1,083	1,151	886
Other Income	52	25	26
Other Deductions	(5)	(4)	(3)
Other-Than-Temporary Impairments	—	(1)	—
Interest Expense	(295)	(310)	(318)
INCOME BEFORE INCOME TAXES	835	861	591
Income Tax (Expense) Benefit	(307)	(340)	(232)
NET INCOME	528	521	359
Preferred Stock Dividends	—	—	(1)
EARNINGS AVAILABLE TO PUBLIC SERVICE ENTERPRISE GROUP INCORPORATED	$ 528	$ 521	$ 358

See disclosures regarding Public Service Electric and Gas Company included in the Notes to Consolidated Financial Statements.

PUBLIC SERVICE ELECTRIC AND GAS COMPANY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
Millions

	Years Ended December 31,		
	2012	2011	2010
NET INCOME	$ 528	$ 521	$ 359
Other Comprehensive Income (Loss), net of tax			
Unrealized Gains (Losses) on Available-for-Sale Securities, net of tax (expense) benefit of $0, $(1) and $3 for the years ended 2012, 2011 and 2010, respectively	—	2	(5)
COMPREHENSIVE INCOME	$ 528	$ 523	$ 354

See disclosures regarding Public Service Electric and Gas Company included in the Notes to Consolidated Financial Statements.

PUBLIC SERVICE ELECTRIC AND GAS COMPANY
CONSOLIDATED BALANCE SHEETS
Millions

	December 31, 2012	December 31, 2011
ASSETS		
CURRENT ASSETS		
Cash and Cash Equivalents	$ 116	$ 143
Accounts Receivable, net of allowances of $56 and $56 in 2012 and 2011, respectively	783	691
Tax Receivable	—	16
Unbilled Revenues	314	289
Materials and Supplies	114	94
Prepayments	29	117
Regulatory Assets	349	167
Derivative Contracts	5	—
Deferred Income Taxes	49	—
Other	24	21
Total Current Assets	1,783	1,538
PROPERTY, PLANT AND EQUIPMENT	17,006	15,306
Less: Accumulated Depreciation and Amortization	(4,726)	(4,539)
Net Property, Plant and Equipment	12,280	10,767
NONCURRENT ASSETS		
Regulatory Assets	3,830	3,805
Regulatory Assets of VIEs	713	925
Long-Term Investments	348	280
Other Special Funds	61	57
Derivative Contracts	62	4
Restricted Cash of VIEs	23	22
Other	123	89
Total Noncurrent Assets	5,160	5,182
TOTAL ASSETS	$ 19,223	$ 17,487

See disclosures regarding Public Service Electric and Gas Company included in the Notes to Consolidated Financial Statements.

PUBLIC SERVICE ELECTRIC AND GAS COMPANY
CONSOLIDATED BALANCE SHEETS
Millions

	December 31, 2012	December 31, 2011
LIABILITIES AND CAPITALIZATION		
CURRENT LIABILITIES		
Long-Term Debt Due Within One Year	$ 725	$ 300
Securitization Debt of VIEs Due Within One Year	226	216
Commercial Paper and Loans	263	—
Accounts Payable	630	498
Accounts Payable—Affiliated Companies, net	73	280
Accrued Interest	65	65
Clean Energy Program	153	214
Derivative Contracts	—	7
Deferred Income Taxes	60	32
Obligation to Return Cash Collateral	122	107
Regulatory Liabilities	67	100
Other	269	186
Total Current Liabilities	2,653	2,005
NONCURRENT LIABILITIES		
Deferred Income Taxes and ITC	4,223	3,675
Other Postretirement Benefit (OPEB) Costs	1,011	900
Accrued Pension Costs	463	355
Regulatory Liabilities	209	228
Regulatory Liabilities of VIEs	10	9
Clean Energy Program	—	39
Environmental Costs	486	592
Asset Retirement Obligations	250	226
Derivative Contracts	107	—
Long-Term Accrued Taxes	32	83
Other	38	35
Total Noncurrent Liabilities	6,829	6,142
COMMITMENTS AND CONTINGENT LIABILITIES (See Note 13)		
CAPITALIZATION		
LONG-TERM DEBT		
Long-Term Debt	4,070	3,970
Securitization Debt of VIEs	496	723
Total Long-Term Debt	4,566	4,693
STOCKHOLDER’S EQUITY		
Common Stock; 150,000,000 shares authorized; issued and outstanding, 2012 and 2011—132,450,344 shares	892	892
Contributed Capital	420	420
Basis Adjustment	986	986
Retained Earnings	2,875	2,347
Accumulated Other Comprehensive Income	2	2
Total Stockholder’s Equity	5,175	4,647
Total Capitalization	9,741	9,340
TOTAL LIABILITIES AND CAPITALIZATION	$ 19,223	$ 17,487

See disclosures regarding Public Service Electric and Gas Company included in the Notes to Consolidated Financial Statements.

PUBLIC SERVICE ELECTRIC AND GAS COMPANY
CONSOLIDATED STATEMENTS OF CASH FLOWS
Millions

	Years Ended December 31, 2012	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES			
Net Income	$ 528	$ 521	$ 359
Adjustments to Reconcile Net Income to Net Cash Flows from Operating Activities:			
Depreciation and Amortization	778	719	750
Provision for Deferred Income Taxes and ITC	442	571	444
Non-Cash Employee Benefit Plan Costs	179	118	217
Cost of Removal	(116)	(62)	(58)
Deferred Storm Costs	(90)	(60)	(8)
Net Change in Regulatory Assets and Liabilities	(132)	(130)	(58)
Net Change in Certain Current Assets and Liabilities:			
Accounts Receivable and Unbilled Revenues	(54)	252	(21)
Materials and Supplies	(20)	(4)	(20)
Prepayments	88	—	(31)
Net Change in Tax Receivable	16	(16)	—
Accounts Receivable/Payable-Affiliated Companies, net	(132)	197	(286)
Other Current Assets and Liabilities	12	(40)	68
Employee Benefit Plan Funding and Related Payments	(213)	(330)	(327)
Other	(30)	40	(18)
Net Cash Provided By (Used In) Operating Activities	1,256	1,776	1,011
CASH FLOWS FROM INVESTING ACTIVITIES			
Additions to Property, Plant and Equipment	(1,770)	(1,302)	(1,257)
Proceeds from Sales of Available-for-Sale Securities	77	—	54
Investments in Available-for-Sale Securities	(77)	—	(54)
Solar Loan Investments	(74)	(51)	(27)
Other	(1)	(1)	4
Net Cash Provided By (Used In) Investing Activities	(1,845)	(1,354)	(1,280)
CASH FLOWS FROM FINANCING ACTIVITIES			
Net Change in Short-Term Debt	263	—	—
Issuance of Long-Term Debt	900	250	1,114
Redemption of Long-Term Debt	(373)	(264)	(400)
Redemption of Securitization Debt	(216)	(206)	(197)
Redemption of Preferred Securities	—	—	(80)
Cash Dividend Paid	—	(300)	(150)
Other	(12)	(4)	(13)
Net Cash Provided By (Used In) Financing Activities	562	(524)	274
Net Increase (Decrease) in Cash and Cash Equivalents	(27)	(102)	5
Cash and Cash Equivalents at Beginning of Period	143	245	240
Cash and Cash Equivalents at End of Period	$ 116	$ 143	$ 245
Supplemental Disclosure of Cash Flow Information:			
Income Taxes Paid (Received)	$ (30)	$ (514)	$ 73
Interest Paid, Net of Amounts Capitalized	$ 280	$ 297	$ 294
Accrued Property, Plant and Equipment Expenditures	$ 275	$ 204	$ 124

See disclosures regarding Public Service Electric and Gas Company included in the Notes to Consolidated Financial Statements.

PUBLIC SERVICE ELECTRIC AND GAS COMPANY
CONSOLIDATED STATEMENTS OF COMMON STOCKHOLDER'S EQUITY
Millions

	Common Stock	Contributed Capital	Basis Adjustment	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance as of January 1, 2010	$ 892	$ 420	$ 986	$ 1,918	$ 5	$ 4,221
Net Income	—	—	—	359	—	359
Other Comprehensive Income, net of tax (expense) benefit of $3	—	—	—	—	(5)	(5)
Comprehensive Income						354
Cash Dividends on Preferred Stock	—	—	—	(1)	—	(1)
Cash Dividends on Common Stock	—	—	—	(150)	—	(150)
Balance as of December 31, 2010	$ 892	$ 420	$ 986	$ 2,126	$ —	$ 4,424
Net Income	—	—	—	521	—	521
Other Comprehensive Income, net of tax (expense) benefit of $(1)	—	—	—	—	2	2
Comprehensive Income						523
Cash Dividends on Common Stock	—	—	—	(300)	—	(300)
Balance as of December 31, 2011	$ 892	$ 420	$ 986	$ 2,347	$ 2	$ 4,647
Net Income	—	—	—	528	—	528
Other Comprehensive Income, net of tax (expense) benefit of $0	—	—	—	—	—	—
Comprehensive Income						528
Cash Dividends on Common Stock	—	—	—	—	—	—
Balance as of December 31, 2012	$ 892	$ 420	$ 986	$ 2,875	$ 2	$ 5,175

See disclosures regarding Public Service Electric and Gas Company included in the Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Organization, Basis of Presentation and Summary of Significant Accounting Policies

Public Service Enterprise Group Incorporated, (PSEG) is a holding company with a diversified business mix within the energy industry. Its operations are primarily in the Northeastern and Mid Atlantic United States and in other select markets. PSEG's principal direct wholly owned subsidiaries are:

- **PSEG Power LLC (Power)**—which is a multi-regional, wholesale energy supply company that integrates its generating asset operations and gas supply commitments with its wholesale energy, fuel supply and energy trading functions through three principal direct wholly owned subsidiaries. Power's subsidiaries are subject to regulation by the Federal Energy Regulatory Commission (FERC), the Nuclear Regulatory Commission (NRC) and the states in which they operate.
- **Public Service Electric and Gas Company (PSE&G)**—which is an operating public utility engaged principally in the transmission of electricity and distribution of electricity and natural gas in certain areas of New Jersey. PSE&G is subject to regulation by the New Jersey Board of Public Utilities (BPU) and the FERC. PSE&G also invests in solar generation projects and has implemented energy efficiency and demand response programs, which are regulated by the BPU.
- **PSEG Energy Holdings L.L.C. (Energy Holdings)**—which primarily has investments in leveraged leases and solar generation projects through its direct wholly owned subsidiaries. Certain Energy Holdings' subsidiaries are subject to regulation by the FERC and the states in which they operate. Energy Holdings has also been awarded a contract to manage the transmission and distribution assets of the Long Island Power Authority (LIPA) starting in 2014.
- **PSEG Services Corporation (Services)**—which provides management, administrative and general services to PSEG and its subsidiaries at cost.

Basis of Presentation

The respective financial statements included herein have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) applicable to Annual Reports on Form 10-K and in accordance with accounting guidance generally accepted in the United States (GAAP).

Significant Accounting Policies

Principles of Consolidation

Each company consolidates those entities in which it has a controlling interest or is the primary beneficiary. See Note 3. Variable Interest Entities. Entities over which the companies exhibit significant influence, but do not have a controlling interest and/or are not the primary beneficiary, are accounted for under the equity method of accounting. For investments in which significant influence does not exist and the investor is not the primary beneficiary, the cost method of accounting is applied. All significant intercompany accounts and transactions are eliminated in consolidation, except as discussed in Note 23. Related-Party Transactions.

Power and PSE&G also have undivided interests in certain jointly-owned facilities, with each responsible for paying its respective ownership share of construction costs, fuel purchases and operating expenses. Power and PSE&G consolidated their portion of any revenues and expenses related to these facilities in the appropriate revenue and expense categories.

Accounting for the Effects of Regulation

In accordance with accounting guidance for rate-regulated entities, PSE&G's financial statements must reflect the economic effects of regulation. PSE&G is required to defer the recognition of costs (a Regulatory Asset) or record the recognition of obligations (a Regulatory Liability) if it is probable that, through the rate-making process, there will be a corresponding increase or decrease in future rates. Accordingly, PSE&G has deferred certain costs and recoveries, which are being amortized over various future periods. To the extent that collection of any such costs or payment of liabilities is no longer probable as a result of changes in regulation and/or competitive position, the associated Regulatory Asset or Liability is charged or credited to income. Management believes that PSE&G's transmission and distribution businesses continue to meet the accounting requirements for rate-regulated entities. For additional information, see Note 6. Regulatory Assets and Liabilities.

Derivative Financial Instruments

Each company uses derivative financial instruments to manage risk from changes in interest rates, commodity prices, congestion costs and emission credit prices, pursuant to its business plans and prudent practices.

Derivative instruments, not designated as normal purchases or sales, are recognized on the balance sheet at their fair value. Changes in the fair value of a derivative that is highly effective as, and that is designated and qualifies as, a fair value hedge, along with changes of the fair value of the hedged asset or liability that are attributable to the hedged risk, are recorded in current period earnings. Changes in the fair value of a derivative that is highly effective as, and that is designated and qualifies as, a cash flow hedge are recorded in Accumulated Other Comprehensive Income (Loss) until earnings are affected by the variability of cash flows of the hedged transaction. Any hedge ineffectiveness is included in current period earnings. For derivative contracts that do not qualify as cash flow or fair value hedges or are not designated as normal purchases or sales, changes in fair value are recorded in current period earnings.

Many non-trading contracts qualify for the normal purchases and normal sales exemption and are accounted for upon settlement.

For additional information regarding derivative financial instruments, see Note 16. Financial Risk Management Activities.

Revenue Recognition

The majority of Power's revenues relate to bilateral contracts, which are accounted for on the accrual basis as the energy is delivered. Power's revenue also includes changes in the value of non-trading energy derivative contracts that are not designated as normal purchases or sales or as cash flow or fair value hedges of other positions. Power records margins from energy trading on a net basis. See Note 16. Financial Risk Management Activities for further discussion.

PSE&G's revenues are recorded based on services rendered to customers. PSE&G records unbilled revenues for the estimated amount customers will be billed for services rendered from the time meters were last read to the end of the respective accounting period. The unbilled revenue is estimated each month based on usage per day, the number of unbilled days in the period, estimated seasonal loads based upon the time of year and the variance of actual degree-days and temperature-humidity-index hours of the unbilled period from expected norms.

Energy Holdings' revenues are earned primarily from income relating to its investments in leveraged leases, which is recognized by a method which produces a constant after-tax rate of return on the outstanding investment in the lease, net of the related deferred tax liability, in the years in which the net investment is positive. Any gains or losses incurred as a result of a lease termination are recorded in Operating Revenues as these events occur in the ordinary course of business of managing the investment portfolio. See Note 7. Long-Term Investments for further discussion.

Depreciation and Amortization

Power calculates depreciation on generation-related assets under the straight-line method based on the assets' estimated useful lives. The estimated useful lives are:

- general plant assets—3 years to 20 years
- fossil production assets—10 years to 79 years
- nuclear generation assets—approximately 60 years
- pumped storage facilities—76 years

PSE&G calculates depreciation under the straight-line method based on estimated average remaining lives of the several classes of depreciable property. These estimates are reviewed on a periodic basis and necessary adjustments are made as approved by the BPU or the FERC. The depreciation rate stated as a percentage of original cost of depreciable property was as follows:

	2012 Avg Rate	2011 Avg Rate	2010 Avg Rate
PSE&G Depreciation Rate	2.48%	2.46%	2.46%

Taxes Other Than Income Taxes

Excise taxes and transitional energy facilities assessment (TEFA) collected from PSE&G's customers are presented in the financial statements on a gross basis. For the years ended December 31, 2012, 2011 and 2010, TEFA is included in the following captions in the Consolidated Statements of Operations:

	Years Ended December 31,		
	2012	2011	2010
		Millions	
TEFA included in:			
Operating Revenues	$ 108	$ 146	$ 149
Taxes Other Than Income Taxes	$ 98	$ 133	$ 136

Interest Capitalized During Construction (IDC) and Allowance for Funds Used During Construction (AFUDC)

IDC represents the cost of debt used to finance construction at Power and Energy Holdings. AFUDC represents the cost of debt and equity funds used to finance the construction of new utility assets at PSE&G. The amount of IDC or AFUDC capitalized as Property, Plant and Equipment is included as a reduction of interest charges or other income for the equity portion. The amounts and average rates used to calculate IDC or AFUDC for the years ended December 31, 2012, 2011 and 2010 were as follows:

	IDC/AFUDC Capitalized					
	2012		2011		2010	
	Millions	Avg Rate	Millions	Avg Rate	Millions	Avg Rate
Power	$ 27	5.16%	$ 30	5.91%	$ 78	6.57%
PSE&G	$ 33	8.43%	$ 13	6.56%	$ 7	6.22%

Income Taxes

PSEG and its subsidiaries file a consolidated federal income tax return and income taxes are allocated to PSEG's subsidiaries based on the taxable income or loss of each subsidiary. Investment tax credits deferred in prior years are being amortized over the useful lives of the related property.

Uncertain income tax positions are accounted for using a benefit recognition model with a two-step approach, a more-likely-than-not recognition criterion and a measurement attribute that measures the position as the largest amount of tax benefit that is greater than 50% likely of being realized upon ultimate settlement. If it is not more-likely-than-not that the benefit will be sustained on its technical merits, no benefit will be recorded. Uncertain tax positions that relate only to timing of when an item is included on a tax return are considered to have met the recognition threshold. See Note 20. Income Taxes for further discussion.

Impairment of Long-Lived Assets

In accordance with accounting guidance, management evaluates long-lived assets for impairment whenever events or changes in circumstances, such as significant adverse changes in regulation, business climate or market conditions, could potentially indicate an asset's or asset group's carrying amount may not be recoverable. In such an event, an undiscounted cash flow analysis is performed to determine if an impairment exists. When a long-lived asset's carrying amount exceeds the undiscounted estimated future cash flows associated with the asset, the asset is considered impaired to the extent that the asset's fair value is less than its carrying amount. An impairment would result in a reduction of the long-lived asset value through a non-cash charge to earnings.

Cash and Cash Equivalents

Cash equivalents consist of short-term, highly liquid investments with original maturities of three months or less.

Accounts Receivable—Allowance for Doubtful Accounts

PSE&G's accounts receivable are reported in the balance sheet as gross outstanding amounts adjusted for doubtful accounts. The allowance for doubtful accounts reflects PSE&G's best estimates of losses on the accounts receivable balances. The allowance is based on accounts receivable aging, historical experience, write-off forecasts and other currently available evidence.

Accounts receivable are charged off in the period in which the receivable is deemed uncollectible. Recoveries of accounts receivable are recorded when it is known they will be received.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Materials and Supplies and Fuel

Materials and supplies for Power and Energy Holdings are valued at the lower of average cost or market. Fuel inventory at Power includes the weighted average costs of stored natural gas, coal, fuel oil and propane used to generate power and to satisfy obligations under Power's gas supply contracts with PSE&G. The costs of fuel, including transportation costs, are included in inventory when purchased and charged at average cost to Energy Costs when used or sold. PSE&G's materials and supplies are carried at average cost consistent with the rate-making process.

Restricted Funds

PSE&G's restricted funds represent revenues collected from its retail electric customers that must be used to pay the principal, interest and other expenses associated with the securitization bonds of PSE&G Transition Funding LLC (Transition Funding) and PSE&G Transition Funding II LLC (Transition Funding II).

Property, Plant and Equipment

Power capitalizes costs which increase the capacity or extend the life of an existing asset, represent a newly acquired or constructed asset or represent the replacement of a retired asset. The cost of maintenance, repair and replacement of minor items of property is charged to appropriate expense accounts as incurred. Environmental costs are capitalized if the costs mitigate or prevent future environmental contamination or if the costs improve existing assets' environmental safety or efficiency. All other environmental expenditures are expensed as incurred.

PSE&G's additions to and replacements of existing property, plant and equipment are capitalized at original cost. The cost of maintenance, repair and replacement of minor items of property is charged to expense as incurred. At the time units of depreciable property are retired or otherwise disposed of, the original cost, adjusted for net salvage value, is charged to accumulated depreciation.

Available-for-Sale Securities

These securities are comprised of the Nuclear Decommissioning Trust (NDT) Fund, a master independent external trust account maintained to provide for the costs of decommissioning upon termination of operations of Power's nuclear facilities and amounts comprising Other Special Funds that are deposited to fund a Rabbi Trust which was established to meet the obligations related to non-qualified pension plans and deferred compensation plans.

Realized gains and losses on available-for-sale securities are recorded in earnings and unrealized gains and losses on such securities are recorded as a component of Accumulated Other Comprehensive Income (Loss) (except credit loss on debt securities which is recorded in earnings). Securities with unrealized losses that are deemed to be other-than-temporarily impaired are recorded in earnings. See Note 9. Available-for-Sale Securities for further discussion.

Pension and Other Postretirement Benefits (OPEB) Plan Assets

The market-related value of plan assets held for the qualified pension and OPEB plans is equal to the fair value of those assets as of year-end. Fair value is determined using quoted market prices and independent pricing services based upon the security type as reported by the trustee at the measurement dates (December 31) for all plan assets. See Note 12. Pension, OPEB and Savings Plans for further discussion.

Basis Adjustment

Power and PSE&G have recorded a Basis Adjustment in their respective Consolidated Balance Sheets related to the generation assets that were transferred from PSE&G to Power in August 2000 at the price specified by the BPU. Because the transfer was between affiliates, the transaction was recorded at the net book value of the assets and liabilities rather than the transfer price. The difference between the total transfer price and the net book value of the generation-related assets and liabilities, $986 million, net of tax, was recorded as a Basis Adjustment on Power's and PSE&G's Consolidated Balance Sheets. The $986 million is a reduction of Power's Member's Equity and an addition to PSE&G's Common Stockholder's Equity. These amounts are eliminated on PSEG's consolidated financial statements.

Use of Estimates

The process of preparing financial statements in conformity with GAAP requires the use of estimates and assumptions regarding certain types of assets, liabilities, revenues and expenses. Such estimates primarily relate to unsettled transactions and events as of the date of the financial statements.

Reclassifications

During 2011, Power sold its two natural gas combined cycle power plants in Texas that were owned and operated by its subsidiary, PSEG Texas. As a result, amounts related to these plants were reclassified as Discontinued Operations in the financial statements of PSEG and Power for the years ended December 31, 2011 and 2010. See Note 4. Discontinued Operations and Dispositions.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2. Recent Accounting Standards

New Standards Adopted during 2012

Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in GAAP and International Financial Reporting Standards (IFRS)

This accounting standard updates guidance related to fair value measurements and disclosures as a step towards achieving convergence between GAAP and IFRS. The updated guidance

- clarifies intent about application of existing fair value measurements and disclosures,
- changes some requirements for fair value measurements, and
- requires expanded disclosures.

We adopted this standard prospectively effective January 1, 2012. Upon adoption there was no material impact on our consolidated financial position, results of operations or cash flows; however, it has resulted in expanded disclosures. For additional information, see Note 17. Fair Value Measurements.

Presentation of Comprehensive Income

This accounting standard addresses the presentation of comprehensive income as a step towards achieving convergence between GAAP and IFRS. The updated guidance

- allows an entity to present components of net income and other comprehensive income in one continuous statement, referred to as the statement of comprehensive income, or in two separate, but consecutive statements, and
- eliminates the current option to report other comprehensive income and its components in the statement of changes in equity.

We adopted this standard retrospectively effective January 1, 2012. Upon adoption of the new amended guidance, there was no impact on our consolidated financial position, results of operations or cash flows, but there was a change in the presentation of the components of other comprehensive income.

New Accounting Standards Issued But Not Yet Adopted

Disclosures about Offsetting Assets and Liabilities

This accounting standard requires balance sheet offsetting disclosures to facilitate comparability between financial statements prepared on the basis of GAAP and IFRS. This standard requires entities

- to disclose information about offsetting and related arrangements to enable users of financial statements to understand the effect of those arrangements on an entity's financial position, and
- to present both net (offset amounts) and gross information in the notes to the financial statements for relevant assets and liabilities that are offset.

The guidance is applicable to certain financial instruments (i.e. derivatives, repurchase agreements and reverse repurchase agreements) and securities borrowing and lending transactions. It is effective for fiscal years and interim periods beginning on or after January 1, 2013. As this standard requires disclosures only, it will not have any impact on our consolidated financial position, results of operations or cash flows.

Reclassification Adjustments out of Accumulated Other Comprehensive Income (AOCI)

This accounting standard requires entities to disclose the following information about reclassification adjustments related to AOCI:

- changes in AOCI balances by components; and
- significant amounts reclassified out of AOCI by respective line items of net income (for amounts that are required by GAAP to be reclassified to net income in their entirety in the same reporting period). For other types of reclassifications, reference to other note disclosures would be required.

The guidance is effective for fiscal years and interim periods beginning on or after January 1, 2013. As this standard requires disclosures only, it will not have any impact on our consolidated financial position, results of operations or cash flows.

Note 3. Variable Interest Entities (VIEs)

VIEs for which PSE&G is the Primary Beneficiary

PSE&G is the primary beneficiary of and consolidates two marginally capitalized VIEs, Transition Funding and Transition Funding II, which were created for the purpose of issuing transition bonds and purchasing bond transitional property of PSE&G, which is pledged as collateral to the trustee for these bonds. PSE&G acts as the servicer for these entities to collect securitization transition charges authorized by the BPU. These funds are remitted to Transition Funding and Transition Funding II and are used for interest and principal payments on the transition bonds and related costs.

The assets and liabilities of these VIEs are presented separately on the face of the Consolidated Balance Sheets of PSEG and PSE&G because the Transition Funding and Transition Funding II assets are restricted and can only be used to settle their respective obligations. The Transition Funding and Transition Funding II creditors do not have any recourse to the general credit of PSE&G in the event the transition charges are not sufficient to cover the bond principal and interest payments of Transition Funding and Transition Funding II, respectively.

PSE&G's maximum exposure to loss is equal to its equity investment in these VIEs which was $16 million as of December 31, 2012 and 2011. PSE&G considers the risk of actual loss to be remote. PSE&G did not provide any financial support to Transition Funding or Transition Funding II in 2012 or 2011. Further, PSE&G does not have any contractual commitments or obligations to provide financial support to Transition Funding and Transition Funding II.

Note 4. Discontinued Operations and Dispositions

Discontinued Operations

Power

In March 2011, Power completed the sale of its 1,000 MW gas-fired Guadalupe generating facility for a total sale price of $ 352 million, resulting in an after-tax gain of $54 million.

In July 2011, Power completed the sale of its 1,000 MW gas-fired Odessa generating facility for a total sale price of $ 335 million, resulting in an after-tax gain of $25 million.

PSEG Texas' operating results for years ended December 31, 2011 and 2010, which were reclassified to Discontinued Operations, are summarized below:

	Years Ended December 31, 2011	2010
	Millions	
Operating Revenues	$ 112	$ 402
Income Before Income Taxes	$ 26	$ 15
Net Income (Loss)	$ 17	$ 7

Dispositions

Leveraged Leases

For the year ended December 31, 2011, Energy Holdings sold its leveraged lease investment in an office building in Denver, Colorado for gross proceeds of $215 million. Proceeds net of sales costs were $175 million.

For the year ended December 31, 2010, Energy Holdings sold its interest in six leveraged leases, including five international leases.

	Years Ended December 31, 2011	2010
	Millions	
Net Proceeds from Sales	$ 175	$ 433
Gain (Loss) on Sales, after-tax	$ 34	$ 30

Note 5. Property, Plant and Equipment and Jointly-Owned Facilities

Information related to Property, Plant and Equipment as of December 31, 2012 and 2011 is detailed below:

	Power	PSE&G	Other	PSEG Consolidated
			Millions	
2012				
Generation:				
Fossil Production	$ 6,886	$ —	$ —	$ 6,886
Nuclear Production	1,415	—	—	1,415
Nuclear Fuel in Service	853	—	—	853
Other Production-Solar	—	434	217	651
Construction Work in Progress	450	7	—	457
Total Generation	9,604	441	217	10,262
Transmission and Distribution:				
Electric Transmission	—	3,053	—	3,053
Electric Distribution	—	6,807	—	6,807
Gas Transmission	—	89	—	89
Gas Distribution	—	5,065	—	5,065
Construction Work in Progress	—	1,048	—	1,048
Plant Held for Future Use	—	6	—	6
Other	—	380	—	380
Total Transmission and Distribution	—	16,448	—	16,448
Other	93	117	482	692
Total	**$ 9,697**	**$ 17,006**	**$ 699**	**$ 27,402**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	Power	PSE&G	Other	PSEG Consolidated
	Millions			
2011				
Generation:				
Fossil Production	$ 6,415	$ —	$ —	$ 6,415
Nuclear Production	1,138	—	—	1,138
Nuclear Fuel in Service	774	—	—	774
Other Production-Solar	—	345	89	434
Construction Work in Progress	784	19	—	803
Total Generation	9,111	364	89	9,564
Transmission and Distribution:				
Electric Transmission	—	2,441	—	2,441
Electric Distribution	—	6,522	—	6,522
Gas Transmission	—	91	—	91
Gas Distribution	—	4,858	—	4,858
Construction Work in Progress	—	546	—	546
Plant Held for Future Use	—	9	—	9
Other	—	386	—	386
Total Transmission and Distribution	—	14,853	—	14,853
Other	80	89	494	663
Total	**$ 9,191**	**$ 15,306**	**$ 583**	**$ 25,080**

Power and PSE&G have ownership interests in and are responsible for providing their respective shares of the necessary financing for the following jointly-owned facilities. All amounts reflect the share of Power's and PSE&G's jointly-owned projects and the corresponding direct expenses are included in the Consolidated Statements of Operations as operating expenses.

December 31, 2012	Ownership Interest	Plant	Accumulated Depreciation
		Millions	
Power:			
Coal Generating			
Conemaugh	23%	$ 321	$ 132
Keystone	23%	$ 387	$ 128
Nuclear Generating			
Peach Bottom	50%	$ 730	$ 193
Salem	57%	$ 865	$ 209
Nuclear Support Facilities	Various	$ 191	$ 29
Pumped Storage Facilities			
Yards Creek	50%	$ 35	$ 23
Merrill Creek Reservoir	14%	$ 1	$ —
PSE&G:			
Transmission Facilities	Various	$ 156	$ 63

December 31, 2011	Ownership Interest	Plant	Accumulated Depreciation
		Millions	
Power:			
Coal Generating			
Conemaugh	23%	$ 289	$ 126
Keystone	23%	$ 381	$ 117
Nuclear Generating			
Peach Bottom	50%	$ 559	$ 171
Salem	57%	$ 807	$ 211
Nuclear Support Facilities	Various	$ 171	$ 27
Pumped Storage Facilities			
Yards Creek	50%	$ 34	$ 23
Merrill Creek Reservoir	14%	$ 1	$ —
PSE&G:			
Transmission Facilities	Various	$ 152	$ 61

Power holds undivided ownership interests in the jointly-owned facilities above, excluding related nuclear fuel and inventories. Power is entitled to shares of the generating capability and output of each unit equal to its respective ownership interests. Power also pays its ownership share of additional construction costs, fuel inventory purchases and operating expenses. Power's share of expenses for the jointly-owned facilities is included in the appropriate expense category. Each owner is responsible for any financing with respect to its pro rata share of capital expenditures.

Power co-owns Salem and Peach Bottom with Exelon Generation. Power is the operator of Salem and Exelon Generation is the operator of Peach Bottom. A committee appointed by the co-owners provides oversight. Proposed Operation and Maintenance (O&M) budgets and requests for major capital expenditures are reviewed and approved as part of the normal Power governance process.

GenOn Northeast Management Company is a co-owner and the operator for Keystone Generating Station and Conemaugh Generating Station. A committee appointed by the co-owners provides oversight. Proposed O&M budgets and requests for major capital expenditures are reviewed and approved as part of the normal Power governance process.

Power is a co-owner in the Yards Creek Pumped Storage Generation Facility. Jersey Central Power & Light Company (JCP&L) is also a co-owner and the operator of this facility. JCP&L submits separate capital and O&M budgets, subject to Power's approval as part of the normal Power governance process.

Power is a minority owner in the Merrill Creek Reservoir and Environmental Preserve in Warren County, New Jersey. Merrill Creek Owners Group is the owner-operator of this facility. The operator submits separate capital and O&M budgets, subject to Power's approval as part of the normal Power governance process.

Note 6. Regulatory Assets and Liabilities

PSE&G prepares its financial statements in accordance with GAAP accounting for regulated utilities. A regulated utility is required to defer the recognition of costs (a Regulatory Asset) or the recognition of obligations (a Regulatory Liability) if it is probable that, through the rate-making process, there will be a corresponding increase or decrease in future rates. Accordingly, PSE&G has deferred certain costs, which will be amortized over various future periods. These costs are deferred based on rate orders issued by the BPU or the FERC or PSE&G's experience with prior rate cases. Most of PSE&G's Regulatory Assets and Liabilities as of December 31, 2012 are supported by written orders, either explicitly or implicitly through the BPU's treatment of various cost items.

Regulatory Assets are subject to prudence reviews and can be disallowed in the future by regulatory authorities. PSE&G believes that all of its Regulatory Assets are probable of recovery. To the extent that collection of any Regulatory Assets or payments of Regulatory Liabilities is no longer probable, the amounts would be charged or credited to income.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

PSE&G had the following Regulatory Assets and Liabilities:

	As of December 31, 2012	As of December 31, 2011	Recovery/Refund Period
	Millions		
Regulatory Assets			
Current:			
Underrecovered Electric Energy Costs—Basic Generation Service (BGS)	$ —	$ 28	Various (1) (2)
Societal Benefits Charges (SBC)	74	87	Annual filing for recovery (1) (2)
Solar and Energy Efficiency Recovery Charges (RRC)	33	6	Annual filing for recovery (1) (2)
Solar Pilot Recovery Charge (SPRC)	14	4	Annual filing for recovery (1) (2)
Capital Stimulus Undercollection	34	21	Annual filing for recovery (1) (2)
Weather Normalization Clause (WNC)	30	2	Annual filing for recovery (2)
New Jersey Clean Energy Program	154	—	Annual filing for recovery (1) (2)
Other	10	19	Various
Total Current Regulatory Assets	**$ 349**	**$ 167**	
Noncurrent			
Stranded Costs To Be Recovered	$ 1,112	$ 1,460	Through December 2016 (1) (2)
Manufactured Gas Plant (MGP) Remediation Costs	588	635	Various (2)
Pension and Other Postretirement	1,550	1,280	Various
Deferred Income Taxes	405	393	Various
Remediation Adjustment Charge (RAC) (Other SBC)	88	92	Through 2019 (1) (2)
New Jersey Clean Energy Program	—	253	Through February 2013 (1) (2)
Mark-to-Market (MTM) Contracts	107	110	Various
Unamortized Loss on Reacquired Debt and Debt Expense	89	96	Over remaining debt life (1)
Conditional Asset Retirement Obligation	110	84	Various
Gas Margin Adjustment Clause	7	29	Through July 2015 (2)
RRC	142	140	Various (2)
WNC Deferral	27	—	Annual filing for recovery (2)
Storm Damage Deferral	244	68	To be determined
Other	74	90	Various
Total Noncurrent Regulatory Assets	**$ 4,543**	**$ 4,730**	
Total Regulatory Assets	**$ 4,892**	**$ 4,897**	

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	As of December 31, 2012	2011	Recovery/Refund Period
	Millions		
Regulatory Liabilities			
Current:			
Market Transition Charge (MTC) Refund, net	$ —	$ 23	Through June 2012 (2)
Deferred Income Taxes	32	39	Various
Overrecovered Gas and Electric Costs—Basic Gas Supply Service (BGSS) and Basic Generation Service (BGS)	21	30	Annual filing for recovery (1) (2)
FERC Formula Rate True-up	5	1	Annual filing for recovery (1) (2)
Non-Utility Generation Charge (NGC)	9	5	Annual filing for recovery (1) (2)
Other	—	2	Various
Total Current Regulatory Liabilities	**$ 67**	**$ 100**	
Noncurrent:			
Electric Cost of Removal	$ 166	$ 222	Reduced as cost is incurred
MTM Contracts	40	—	Various
Other	13	15	Various
Total Noncurrent Regulatory Liabilities	**$ 219**	**$ 237**	
Total Regulatory Liabilities	**$ 286**	**$ 337**	

(1) Recovered/Refunded with interest.
(2) Recoverable/Refundable per specific rate order.

All Regulatory Assets and Liabilities are excluded from PSE&G's rate base unless otherwise noted. The Regulatory Assets and Liabilities in the table above are defined as follows:

- **Underrecovered Electric Energy Costs:** These costs represent the underrecovered amounts associated with BGS, as approved by the BPU.
- **SBC:** The SBC, as authorized by the BPU and the New Jersey Electric Discount and Energy Competition Act (Competition Act), includes costs related to PSE&G's electric and gas business as follows: 1) the USF; 2) Energy Efficiency and Renewable Energy Programs; 3) Social Programs (electric only) which include electric bad debt expense; and 4) the RAC for incurred MGP remediation expenditures. All components accrue interest on both over and underrecoveries.
- **RRC:** These costs are amounts associated with various renewable energy and energy efficiency programs. Components of the RRC include: Carbon Abatement, Energy Efficiency Economic Stimulus Program, Energy Efficiency Economic Extension Program, the Demand Response Program, Solar Generation Investment Program (Solar 4 All) and Solar Loan II Program.
- **SPRC:** This charge is designed to recover the revenue requirements associated with the PSE&G Solar Pilot Program (Solar Loan I) per the BPU Order, less the net proceeds from the sale of associated Solar Renewable Energy Certificates (SRECs) or cash received in lieu of SRECs. The net recovery is subject to deferred accounting. Interest at the two-year constant maturity treasury rate plus 60 basis points will be accrued monthly on any under- or over-recovered balances.
- **Capital Stimulus Undercollection:** PSE&G has received approval from the BPU for programs that provide for accelerated investment in utility infrastructure. The goal of these accelerated capital investments is to improve the reliability of PSE&G's infrastructure and New Jersey's economy through job creation.
- **WNC Deferral:** This represents the over or under collection of gas margin refundable or recoverable under the BPU's weather normalization clause. The WNC requires PSE&G to calculate, at the end of each October-to-May period, the level by which margin revenues differed from what would have resulted if normal weather had occurred.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

- **New Jersey Clean Energy Program:** The BPU approved future funding requirements for Energy Efficiency and Renewable Energy Programs through the first half of 2013. Once the rates are measured, they are recovered through the SBC.
- **Stranded Costs To Be Recovered:** This reflects deferred costs, which are being recovered through the securitization transition charges authorized by the BPU in irrevocable financing orders and being collected by PSE&G, as servicer on behalf of Transition Funding and Transition Funding II, respectively. Collected funds collected are remitted to Transition Funding and Transition Funding II and are used for interest and principal payments on the transition bonds and related costs and taxes.

  Transition Funding and Transition Funding II are wholly owned, bankruptcy-remote subsidiaries of PSE&G that purchased certain transition property from PSE&G and issued transition bonds secured by such property. The transition property consists principally of the rights to receive electricity consumption-based per kilowatt-hour (kWh) charges from PSE&G electric distribution customers, which represent irrevocable rights to receive amounts sufficient to recover certain of PSE&G's transition costs related to deregulation, as approved by the BPU.
- **MGP Remediation Costs:** Represents the low end of the range for the remaining environmental investigation and remediation program cleanup costs for manufactured gas plants that are probable of recovery in future rates. Once these costs are incurred, they are recovered through the RAC in the SBC.
- **Pension and Other Postretirement:** Pursuant to the adoption of accounting guidance for employers' defined benefit pension and OPEB plans, PSE&G recorded the unrecognized costs for defined benefit pension and other OPEB plans on the balance sheet as a Regulatory Asset. These costs represent actuarial gains or losses, prior service costs and transition obligations as a result of adoption, which have not been expensed. These costs are amortized and recovered in future rates.
- **Deferred Income Taxes:** These amounts represent the portion of deferred income taxes that will be recovered or refunded through future rates, based upon established regulatory practices.
- **RAC (Other SBC):** Costs incurred to clean up manufactured gas plants which are recovered over seven years.
- **MTM Contracts:** The estimated fair value of long-term standard offer capacity agreements (SOCAs), gas hedge contracts and gas cogeneration supply contracts. The regulatory asset/liability is offset by a derivative asset/liability and, with respect to the gas hedge contracts only, an intercompany receivable/payable on the Consolidated Balance Sheets.
- **Unamortized Loss on Reacquired Debt and Debt Expense:** Represents losses on reacquired long-term debt, which are recovered through rates over the remaining life of the debt.
- **Conditional Asset Retirement Obligation:** These costs represent the differences between rate regulated cost of removal accounting and asset retirement accounting under GAAP. These costs will be recovered in future rates.
- **Gas Margin Adjustment Clause:** PSE&G defers the margin differential received from Transportation Gas Service Non-Firm Customers versus bill credits provided to BGSS-Firm customers.
- **Storm Damage Deferral:** Costs incurred in the cleanup of 2012, 2011 and 2010 storms, as approved by the BPU under an Order received in December 2012 authorizing the deferral of incremental costs.
- **MTC Refund, net:** These costs represent the overrecovered amounts associated with MTC.
- **Overrecovered Gas and Electric Costs:** These costs represent the overrecovered amounts associated with BGSS and BGS, as approved by the BPU. Interest is accrued on overrecovered balances.
- **FERC Formula Rate True-up:** Overcollection or undercollection of transmission earnings calculated using a FERC approved formula.
- **NGC:** Represents the difference between the cost of non-utility generation and the amounts realized from selling that energy at market rates through PJM and ratepayer collections.
- **Electric Cost of Removal:** PSE&G accrues and collects for cost of removal in rates. The liability for non-legally required cost of removal is classified as a Regulatory Liability. This liability is reduced as removal costs are incurred. Accumulated cost of removal is a reduction to the rate base.

Significant 2012 orders and pending rate filings are as follows:

- ***Storm Damage Deferral***—In December 2012, the BPU granted PSE&G's request to defer on its books actually incurred, uninsured, incremental storm restoration costs to its gas and electric distribution systems associated with extraordinary storms, including Hurricane Irene and Superstorm Sandy. In February 2013, the BPU announced that it would initiate a generic proceeding to evaluate the prudency of extraordinary, storm-related costs incurred by all of the regulated utilities as a result of the natural disasters experienced in New Jersey in 2011 and 2012 and in this proceeding will consider the manner in which such prudent costs shall be recovered.
- ***Transmission Formula Rates***—PSE&G's 2012 Annual Formula Rate Update with the FERC provided for approximately $94 million in increased annual transmission revenues effective January 1, 2012. PSE&G filed its 2013 Annual Formula Rate Update with FERC in October 2012, which provides for approximately $174 million in increased annual transmission revenues effective January 1, 2013.
- ***SBC/NGC***—In March 2012, PSE&G made an annual SBC/NGC filing requesting a $5 million electric increase and a $29 million gas increase. PSE&G updated the filing with actual data through August 31, 2012, resulting in a decrease of $77 million for electric customers while the gas increase remained unchanged. A Stipulation signed by the Parties was approved by the BPU effective February 1, 2013.
- ***Universal Service Fund (USF)/Lifeline***—The USF is an energy assistance program mandated by the BPU to provide payment assistance to low income customers. The Lifeline program is a separate mandated energy assistance program to provide payment assistance to elderly and disabled customers. In June 2012, New Jersey's electric and gas utilities, including PSE&G, filed requests to reset the statewide rates for the USF and the Lifeline program. The filed USF rates were set to recover approximately $230 million on a statewide basis. Of this amount, the statewide electric rates are set to recover $173 million with the remaining $57 million recovered through gas rates. The rates for the Lifeline program were set to recover $66 million, $46 million for electric and $20 million for gas. The filed rates were subsequently updated and approved effective October 1, 2012. PSE&G earns no margin on the collection of the USF and Lifeline programs resulting in no impact on Net Income.
- ***Capital Infrastructure Programs (CIP I and CIP II)***—In December 2012, the BPU approved stipulations regarding our CIP I and CIP II filings resulting in a combined increase of $40 million and $23 million for electric and gas customers, respectively effective January 1, 2013.
- ***WNC***— In June 2012, PSE&G filed a petition and testimony with the BPU, including eight months of actual and four months of forecasted data, which sought BPU approval to recover $41 million in deficiency revenues from its customers during the 2012-2013 Winter Period (October 1 to May 31) and a carryover deficiency of $16 million to the 2013-2014 Winter Period. In September 2012, an Order approving the stipulation for provisional rates was signed. In December 2012, PSE&G made a supplemental filing incorporating twelve months of actual financial data, which would, if approved by the BPU, result in no change to customer rates during the 2012-2013 Winter Period. The supplemental filing would, however, result in an increase of the carryover deficiency to the 2013-2014 Winter Period from $16 million to $24 million. PSE&G is awaiting a final Order.
- ***RAC***—In November 2011, PSE&G filed a RAC 19 petition with the BPU requesting a decrease in electric and gas RAC revenues on an annual basis of $9 million and $10 million, respectively. In October 2012, PSE&G received the Administrative Law Judge's (ALJ) Initial Decision allowing full recovery of RAC 19 costs including costs of the Passaic River and Newark Bay Superfund (CERCLA) matters and the Occidental litigation that were allocated to PSE&G and included in this request. In October 2012, the BPU issued a final Order approving the ALJ's Initial Decision.
- ***RRC***—In July 2012, PSE&G filed a petition with the BPU requesting an increase in the RRC seeking to recover approximately $62 million in electric revenue and $8 million in gas revenue on an annual basis. The discovery phase of this proceeding is underway.
- ***SPRC***—In July 2012, the BPU approved a Stipulation regarding our March 2010 SPRC (Solar Loan I) filing authorizing an increase in rates of $3 million for PSE&G's electric customers effective August 1, 2012. In July 2012, PSE&G filed a petition with the BPU for an annual increase in the electric SPRC of $17 million. The discovery phase of this proceeding is underway.

Note 7. Long-Term Investments

Long-Term Investments as of December 31, 2012 and 2011 included the following:

	As of December 31, 2012	As of December 31, 2011
	Millions	
Power		
Partnerships and Corporate Joint Ventures (Equity Method Investments)	$ 40	$ 32
PSE&G		
Life Insurance and Supplemental Benefits	161	162
Solar Loan Investments	180	111
Other Investments	7	7
Energy Holdings		
Leveraged Leases	840	881
Partnerships and Corporate Joint Ventures:		
Equity Method Investments (A)	94	106
Cost Method Investments (B)	2	4
Total Long-Term Investments	**$ 1,324**	**$ 1,303**

(A) During the three years ended December 31, 2012, 2011 and 2010, the amount of dividends from these investments was $17 million, $3 million and $5 million, respectively. Energy Holdings’ share of income and cash flow distribution percentages were at 50% as of December 31, 2012.

(B) Reflects Energy Holdings' investments in certain companies in which it does not have the ability to exercise significant influence. Such investments are accounted for under the cost method.

Leases

Energy Holdings has investments in domestic energy and real estate assets subject primarily to leveraged lease accounting. A leveraged lease is typically comprised of an investment by an equity investor and debt provided by a third party debt investor. The debt is recourse only to the assets subject to lease and is not included on PSEG’s Consolidated Balance Sheets. As an equity investor, Energy Holdings’ equity investments in the leases are comprised of the total expected lease receivables over the lease terms plus the estimated residual values at the end of the lease terms, reduced for any income not yet earned on the leases. This amount is included in Long-Term Investments on PSEG’s Consolidated Balance Sheets. The more rapid depreciation of the leased property for tax purposes creates tax cash flow that will be repaid to the taxing authority in later periods. As such, the liability for such taxes due is recorded in Deferred Income Taxes on PSEG’s Consolidated Balance Sheets. The following table shows Energy Holdings’ gross and net lease investment as of December 31, 2012 and 2011, respectively.

	As of December 31, 2012	As of December 31, 2011
	Millions	
Lease Receivables (net of Non-Recourse Debt)	$ 721	$ 763
Estimated Residual Value of Leased Assets	535	553
	1,256	1,316
Unearned and Deferred Income	(416)	(435)
Gross Investments in Leases	840	881
Deferred Tax Liabilities	(723)	(716)
Net Investments in Leases	**$ 117**	**$ 165**

The pre-tax income and income tax effects, excluding gains and losses on sales, related to investments in leases were as follows:

	Years Ended December 31, 2012	2011	2010
	Millions		
Pre-Tax Income (Loss) from Leases	$ 78	$ (228)	$ 45
Income Tax Expense (Benefit) on Pre-Tax Income from Leases	$ 34	$ (77)	$ 14

Equity Method Investments

Power and Energy Holdings had the following equity method investments as of December 31, 2012:

Name	Location	% Owned
Power		
Keystone Fuels, LLC	PA	23%
Conemaugh Fuels, LLC	PA	23%
Energy Holdings		
Kalaeloa	HI	50%
GWF	CA	50%
Hanford L. P. (Hanford)	CA	50%

Note 8. Financing Receivables

PSE&G

PSE&G sponsors a solar loan program designed to help finance the installation of solar power systems throughout its electric service area. The loans are generally paid back with SRECS generated from the installed solar electric system. The following table reflects the outstanding short and long-term loans by class of customer, none of which would be considered "non-performing."

Credit Risk Profile Based on Payment Activity

Consumer Loans	As of December 31, 2012	2011
	Millions	
Commercial/Industrial	$ 174	$ 106
Residential	15	10
	$ 189	**$ 116**

Energy Holdings

Energy Holdings had a net investment in domestic energy and real estate assets subject primarily to leveraged lease accounting of $117 million and $165 million as of December 31, 2012 and 2011, respectively (See Note 7. Long-Term Investments).

The corresponding receivables associated with the lease portfolio are reflected below, net of non-recourse debt. The ratings in the table represent the ratings of the entities providing payment assurance to Energy Holdings. "Not Rated" counterparties relate to investments in leases of commercial real estate properties.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Counterparties' Credit Rating (S&P) as of December 31, 2012	Lease Receivables, Net of Non-Recourse Debt As of December 31, 2012	2011
	Millions	
AA	$ 21	$ 21
AA-	73	110
BBB+ - BBB-	316	316
B	166	299
D	134	—
Not Rated	11	17
	$ 721	**$ 763**

The "B" and "D" ratings above represent lease receivables related to coal-fired assets in Illinois and Pennsylvania. As of December 31, 2012, the gross investment in the leases of such assets, net of non-recourse debt, was $559 million ($19 million, net of deferred taxes). A more detailed description of such assets under lease is presented in the following table.

Asset	Location	Gross Investment	% Owned	Total	Fuel Type	Counterparties' S&P Credit Ratings	Counterparty
		Millions		MW			
Powerton Station Units 5 and 6	IL	$ 134	64%	1,538	Coal	D	Edison Mission Energy
Joliet Station Units 7 and 8	IL	$ 84	64%	1,044	Coal	D	Edison Mission Energy
Keystone Station Units 1 and 2	PA	$ 116	17%	1,711	Coal	B	GenOn REMA, LLC
Conemaugh Station Units 1 and 2	PA	$ 116	17%	1,711	Coal	B	GenOn REMA, LLC
Shawville Station Units 1, 2, 3 and 4	PA	$ 109	100%	603	Coal	B	GenOn REMA, LLC

The credit exposure for lessors is partially mitigated through various credit enhancement mechanisms within the lease transactions. These credit enhancement features vary from lease to lease and may include letters of credit or affiliate guarantees. Upon the occurrence of certain defaults, indirect subsidiary companies of Energy Holdings would exercise their rights and attempt to seek recovery of their investment, potentially including stepping into the lease directly to protect their investments. While these actions could ultimately protect or mitigate the loss of value, they could require the use of significant capital investments and trigger certain material tax obligations. A bankruptcy of a lessee would likely delay any efforts on the part of the lessors to assert their rights upon default and could delay the monetization of claims. Failure to recover adequate value could ultimately lead to a foreclosure on the lease by the lenders. If foreclosures were to occur, Energy Holdings could potentially record a pre-tax write-off up to its gross investment in these facilities and may also be required to pay significant cash tax liabilities.

Of facilities under lease by indirect subsidiary companies of Energy Holdings to GenOn REMA, LLC (GenOn REMA), a subsidiary of GenOn Energy Inc. (GenOn), which was acquired by NRG Energy, Inc. in December 2012. Keystone has installed flue gas desulfurization control for sulfur dioxide (SO_2), selective catalytic reduction (SCR) equipment for nitrogen oxide (NOx) and mercury control to meet current environmental requirements. Conemaugh has flue gas desulfurization control, while SCR and mercury control are scheduled to be installed and operational in the first quarter of 2015. GenOn's plan for the coal-fired units at the Shawville facility is to place them in a "long-term protective layup" by April 2015 while continuing to pay the required rent and maintaining the facility in accordance with the lease terms or terminating the lease for obsolescence in which case the lessee would be required, among other things, to pay the contractual termination value structured to recover Energy Holdings' indirect subsidiaries' lease investment as specified in the lease agreement.

Although all lease payments from the GenOn REMA leases are current, no assurances can be given that future payments in accordance with the lease contracts will continue. Factors which may impact future lease cash flows include, but are not limited to, new environmental legislation and regulation regarding air quality, water and other discharges in the process of generating electricity, market prices for fuel and electricity, overall financial condition of lease counterparties and the quality and condition of assets under lease.

With respect to Edison Mission Energy's (EME) Midwest Generation (MWG) leases on the Powerton and Joliet coal units in Illinois, the lessee, MWG, substantially completed investments in mercury removal (Activated Carbon Injection) and NOx emission controls (low NOx burners and Selective Non-Catalytic Reduction systems), and plans to invest in SO_2 emission controls (Dry Sorbent Injection (Trona) systems). EME does not anticipate a material change in this current approach in order to comply with existing federal and Illinois environmental rules. On November 30, 2012, MWG filed a variance request with the Illinois Pollution Control Board seeking two additional years to meet upcoming air emission compliance deadlines under Illinois law. EME and MWG remain in litigation with the U.S. Environmental Protection Agency (EPA) and the State of Illinois regarding certain air emissions. On March 16, 2011, the federal district court dismissed new source review claims in reference to Powerton and Joliet, but certain opacity claims remain pending against MWG. The EPA and the State of Illinois have appealed the dismissal of the new source review claims. On November 11, 2011, the federal district court stayed proceedings in connection with the opacity claims until the appeal by the EPA and the State of Illinois is resolved.

On December 17, 2012, EME and MWG filed for relief under Chapter 11 of the U.S. Bankruptcy Code. Immediately prior to that filing, EME, MWG, Nesbitt Asset Recovery, LLC (which is an indirect, wholly owned subsidiary of Energy Holdings), and Associates Capital Investments, L.L.P., as well as certain affiliated owner lessors and owner participants, entered into a forbearance agreement with holders of a majority of the lease debt that financed the original sale-leaseback transaction. The forbearance agreement, which was approved by the bankruptcy court and limited the ability of the lease indenture trustee to accelerate or exercise other remedies with respect to that nonrecourse debt, expired on February 15, 2013. A new forbearance agreement is currently being negotiated by the parties. MWG has not determined whether to assume or reject those leases. MWG did not make its scheduled rent payments (which related to the prior six month period) totaling approximately $48 million on the Powerton and Joliet leases due on January 2, 2013, most of which is a pre-petition bankruptcy claim. Rental for the utilization of the facilities by MWG during pendency of the bankruptcy will likely be treated as an administrative expense in bankruptcy. In mid-February, pursuant to the terms of the forbearance agreement, a rental payment of approximately $5 million was received covering the period from the date of the petition filing through January 2, 2013.

On December 13, 2011, indirect subsidiary companies of Energy Holdings and Dynegy Incorporated (Dynegy) reached a settlement agreement resolving disputes that had arisen between them with regard to Dynegy Holding’s (DH) rejection of the Dynegy leases. The settlement agreement resolved certain disputes regarding Energy Holdings' Dynegy leases, including claims under Tax Indemnity Agreements that indirect subsidiaries of Energy Holdings have with DH. The original terms of the settlement agreement included a cash payment to Energy Holdings of $7.5 million, which was received on January 4, 2012, and an allowed claim in Bankruptcy Court of $110 million against DH. On December 30, 2011, the effective date of the court order authorizing the Dynegy lease rejections, the leases no longer qualified for leveraged lease accounting treatment under GAAP. As a result, Energy Holdings wrote off the $264 million gross lease investment against the previously recorded reserve. The Energy Holdings' indirect subsidiary companies that are owners/lessors of the two plants ceased leveraged lease accounting and recorded the generation assets and related nonrecourse project debt on their balance sheets at their respective fair values (See Note 17. Fair Value Measurements).

On June 1, 2012, an amended and restated settlement agreement entered into by DH, Dynegy and their creditors (including indirect subsidiary companies of Energy Holdings) was approved by the Bankruptcy Court. The agreement allocated proceeds from the sale of the facilities to pay DH’s creditors, including the lease bondholders, and grants the lease bondholders claims in agreed upon amounts against DH in its bankruptcy proceedings. The settlement agreement also included an exchange of releases by various settling claimants, including parties to the leases with respect to claims arising out of the leases. On October 1, 2012, Dynegy emerged from bankruptcy and distributed cash and stock settlements to the claimants. The total recovery of Energy Holdings' indirect subsidiary companies from the Dynegy leases was approximately $63 million, of which $50 million was recorded in Operating Revenues in the fourth quarter of 2012.

Note 9. Available-for-Sale Securities

NDT Fund

In accordance with NRC regulations, entities owning an interest in nuclear generating facilities are required to determine the costs and funding methods necessary to decommission such facilities upon termination of operation. As a general practice, each nuclear owner places funds in independent external trust accounts it maintains to provide for decommissioning. Power is required to file periodic reports with the NRC demonstrating that the NDT Fund meets the formula-based minimum NRC funding requirements.

Power maintains an external master NDT to fund its share of decommissioning for its five nuclear facilities upon their respective termination of operation. The trust contains two separate funds: a qualified fund and a non-qualified fund.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Section 468A of the Internal Revenue Code limits the amount of money that can be contributed into a qualified fund. Power's share of decommissioning costs related to its five nuclear units was estimated to be between $2.2 billion and $2.4 billion, including contingencies. The liability for decommissioning recorded on a discounted basis as of December 31, 2012 was approximately $348 million and is included in the Asset Retirement Obligation. The trust funds are managed by third-party investment advisors who operate under investment guidelines developed by Power. In September 2012, Power revised the asset structure for a portion of its NDT Fund and realized gains of $59 million. The investments were transitioned to new investment managers to remove under-performing managers.

Power classifies investments in the NDT Fund as available-for-sale. The following tables show the fair values and gross unrealized gains and losses for the securities held in the NDT Fund:

	As of December 31, 2012			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	Millions			
Equity Securities	$ 648	$ 147	$ (6)	$ 789
Debt Securities				
Government Obligations	274	11	—	285
Other Debt Securities	320	22	—	342
Total Debt Securities	594	33	—	627
Other Securities	124	—	—	124
Total NDT Available-for-Sale Securities	**$ 1,366**	**$ 180**	**$ (6)**	**$ 1,540**

	As of December 31, 2011			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	Millions			
Equity Securities	$ 582	$ 126	$ (23)	$ 685
Debt Securities				
Government Obligations	343	16	—	359
Other Debt Securities	268	15	(2)	281
Total Debt Securities	611	31	(2)	640
Other Securities	24	—	—	24
Total NDT Available-for-Sale Securities	**$ 1,217**	**$ 157**	**$ (25)**	**$ 1,349**

These amounts do not include receivables and payables for NDT Fund transactions which have not settled at the end of each period. Such amounts are included in Accounts Receivable and Accounts Payable on the Consolidated Balance Sheets as shown in the following table.

	As of December 31, 2012	As of December 31, 2011
	Millions	
Accounts Receivable	$ 18	$ 27
Accounts Payable	$ 53	$ 22

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table shows the value of securities in the NDT Fund that have been in an unrealized loss position for less than 12 months and greater than 12 months:

	As of December 31, 2012				As of December 31, 2011			
	Less Than 12 Months		Greater Than 12 Months		Less Than 12 Months		Greater Than 12 Months	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	Millions							
Equity Securities (A)	$ 139	$ (6)	$ —	$ —	$ 183	$ (23)	$ —	$ —
Debt Securities								
Government Obligations (B)	34	—	1	—	20	—	3	—
Other Debt Securities (C)	31	—	6	—	56	(1)	4	(1)
Total Debt Securities	65	—	7	—	76	(1)	7	(1)
NDT Available-for-Sale Securities	**$ 204**	**$ (6)**	**$ 7**	**$ —**	**$ 259**	**$ (24)**	**$ 7**	**$ (1)**

(A) Equity Securities—Investments in marketable equity securities within the NDT Fund are primarily in common stocks within a broad range of industries and sectors. The unrealized losses are distributed over hundreds of companies with limited impairment durations. Power does not consider these securities to be other-than-temporarily impaired as of December 31, 2012.

(B) Debt Securities (Government)—Unrealized losses on Power's NDT investments in United States Treasury obligations and Federal Agency mortgage-backed securities were caused by interest rate changes. Since these investments are guaranteed by the United States government or an agency of the United States government, it is not expected that these securities will settle for less than their amortized cost basis, since Power does not intend to sell nor will it be more-likely-than-not required to sell. Power does not consider these securities to be other-than-temporarily impaired as of December 31, 2012.

(C) Debt Securities (Corporate)—Power's investments in corporate bonds are primarily in investment grade securities. It is not expected that these securities would settle for less than their amortized cost. Since Power does not intend to sell these securities nor will it be more-likely-than-not required to sell, Power does not consider these debt securities to be other-than-temporarily impaired as of December 31, 2012.

The proceeds from the sales of and the net realized gains on securities in the NDT Fund were:

	Years Ended December 31,		
	2012	2011	2010
	Millions		
Proceeds from Sales	**$ 1,433**	**$ 1,355**	**$ 958**
Net Realized Gains:			
Gross Realized Gains	$ 153	$ 144	$ 119
Gross Realized Losses	(52)	(45)	(39)
Net Realized Gains (Losses) on NDT Fund	**$ 101**	**$ 99**	**$ 80**

Net realized gains disclosed in the above table were recognized in Other Income and Other Deductions in PSEG's and Power's Consolidated Statements of Operations. Net unrealized gains of $84 million (after-tax) are included in Accumulated Other Comprehensive Loss on Power's Consolidated Balance Sheet as of December 31, 2012.

Table of Contents

The available-for-sale debt securities held as of December 31, 2012 had the following maturities:

Time Frame	Fair Value
	Millions
Less than one year	$ 18
1 - 5 years	136
6 - 10 years	176
11 - 15 years	42
16 - 20 years	10
Over 20 years	245
Total NDT Available-for-Sale Debt Securities	**$ 627**

The cost of these securities was determined on the basis of specific identification.

Power periodically assesses individual securities whose fair value is less than amortized cost to determine whether the investments are considered to be other-than-temporarily impaired. For equity securities, management considers the ability and intent to hold for a reasonable time to permit recovery in addition to the severity and duration of the loss. For fixed income securities, management considers its intent to sell or requirement to sell a security prior to expected recovery. In those cases where a sale is expected, any impairment would be recorded through earnings. For fixed income securities where there is no intent to sell or likely requirement to sell, management evaluates whether credit loss is a component of the impairment. If so, that portion is recorded through earnings while the noncredit loss component is recorded through Accumulated Other Comprehensive Income (Loss). In 2012, other-than-temporary impairments of $18 million were recognized on securities in the NDT Fund. Any subsequent recoveries in the value of these securities would be recognized in Accumulated Other Comprehensive Income (Loss) unless the securities are sold, in which case, any gain would be recognized in income. The assessment of fair market value compared to cost is applied on a weighted average basis taking into account various purchase dates and initial cost of the securities.

Rabbi Trust

PSEG maintains certain unfunded nonqualified benefit plans to provide supplemental retirement and deferred compensation benefits to certain key employees. Certain assets related to these plans have been set aside in a grantor trust commonly known as a “Rabbi Trust.”

In March 2012, PSEG restructured the fixed income component of its Rabbi Trust and realized a gain of $5 million. In August 2010, PSEG revised the asset structure of the Rabbi Trust and realized gains of approximately $31 million as the investments were transitioned to a new asset allocation and investment manager.

PSEG classifies investments in the Rabbi Trust as available-for-sale. The following tables show the fair values, gross unrealized gains and losses and amortized cost bases for the securities held in the Rabbi Trust.

	As of December 31, 2012			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
		Millions		
Equity Securities	$ 13	$ 5	$ —	$ 18
Debt Securities				
Government Obligations	114	3	—	117
Other Debt Securities	45	2	—	47
Total Debt Securities	159	5	—	164
Other Securities	3	—	—	3
Total Rabbi Trust Available-for-Sale Securities	**$ 175**	**$ 10**	**$ —**	**$ 185**

	As of December 31, 2011			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	Millions			
Equity Securities	$ 16	$ 3	$ —	$ 19
Debt Securities	148	5	—	153
Total Rabbi Trust Available-for-Sale Securities	**$ 164**	**$ 8**	**$ —**	**$ 172**

As of December 31, 2012, amounts in the above table do not include Accounts Receivable of $4 million and Accounts Payable of $5 million for Rabbi Trust Fund transactions which had not yet settled. These amounts are included on the Consolidated Balance Sheets.

	Years Ended December 31,		
	2012	2011	2010
	Millions		
Proceeds from Rabbi Trust Sales	**$ 233**	**$ —**	**$ 158**
Net Realized Gains (Losses):			
Gross Realized Gains	$ 6	$ —	$ 31
Gross Realized Losses	—	—	—
Net Realized Gains (Losses) on Rabbi Trust	**$ 6**	**$ —**	**$ 31**

Gross realized gains disclosed in the above table were recognized in Other Income in the Consolidated Statements of Operations. Net unrealized gains of $ 6 million (after-tax) were recognized in Accumulated Other Comprehensive Loss on the Consolidated Balance Sheets as of December 31, 2012. The Rabbi Trust available-for-sale debt securities held as of December 31, 2012 had the following maturities:

Time Frame	Fair Value
	Millions
Less than one year	$ —
1 - 5 years	60
6 - 10 years	31
11 - 15 years	9
16 - 20 years	5
Over 20 years	59
Total Rabbi Trust Available-for-Sale Debt Securities	**$ 164**

The cost of these securities was determined on the basis of specific identification.

PSEG periodically assesses individual securities whose fair value is less than amortized cost to determine whether the investments are considered to be other-than-temporarily impaired. For equity securities, the Rabbi Trust is invested in a commingled indexed mutual fund. Due to the commingled nature of this fund, PSEG does not have the ability to hold these securities until expected recovery. As a result, any declines in fair market value below cost are recorded as a charge to earnings. For fixed income securities, management considers its intent to sell or requirement to sell a security prior to expected recovery. In those cases where a sale is expected, any impairment would be recorded through earnings. For fixed income securities where there is no intent to sell or likely requirement to sell, management evaluates whether credit loss is a component of the impairment. If so, that portion is recorded through earnings while the noncredit loss component is recorded through Accumulated Other Comprehensive Income (Loss). The assessment of fair market value compared to cost is applied on a weighted average basis taking into account various purchase dates and initial cost of the securities. In 2012, there were no other-than-temporary impairments recognized on investments of the Rabbi Trust.

The fair value of the Rabbi Trust related to PSEG, Power and PSE&G are detailed as follows:

	As of December 31, 2012	As of December 31, 2011
	Millions	
Power	$ 36	$ 33
PSE&G	61	57
Other	88	82
Total Rabbi Trust Available-for-Sale Securities	**$ 185**	**$ 172**

Note 10. Goodwill and Other Intangibles

As of each of December 31, 2012 and 2011, Power had goodwill of $16 million related to the Bethlehem Energy Center. Power conducted an annual review for goodwill impairment as of October 31, 2012 and concluded that goodwill was not impaired. No events occurred subsequent to that date which would require a further review of goodwill for impairment.

In addition to goodwill, as of December 31, 2012 and 2011, Power had intangible assets of $34 million and $131 million, respectively, related to emissions allowances and renewable energy credits. Emissions expense includes impairments of emissions allowances and costs for emissions, which is recorded as emissions occur. As load is served under contracts requiring energy from renewable sources, the related expense is recorded. Such expenses for the years ended December 31, 2012, 2011 and 2010 were as follows:

	Years Ended December 31, 2012	2011	2010
		Millions	
Emissions Expense	$ 5	$ 35	$ 52
Renewable Energy Expense	$ 34	$ 43	$ 50

Note 11. Asset Retirement Obligations (AROs)

PSEG, Power and PSE&G have recorded various AROs which represent legal obligations to remove or dispose of an asset or some component of an asset at retirement.

Power's ARO liability primarily relates to the decommissioning of its nuclear power plants in accordance with NRC requirements. To estimate this decommissioning obligation related to its nuclear power plants, Power uses a probability weighted, discounted cash flow model which, on a unit by unit basis, considers multiple outcome scenarios that include significant estimates and assumptions, and are based on decommissioning studies, cost escalation rates, inflation rates and discount rates. Power has an independent external trust that is intended to fund decommissioning of its nuclear facilities upon termination of operation. For additional information, see Note 9. Available-for-Sale Securities. Power also identified conditional AROs primarily related to Power's fossil generation units, including liabilities for

- removal of asbestos, stored hazardous liquid material and underground storage tanks from industrial power sites,
- restoration of leased office space to rentable condition upon lease termination,
- permits and authorizations,
- restoration of an area occupied by a reservoir when the reservoir is no longer needed, and
- demolition of certain plants, and the restoration of the sites at which they reside, when the plants are no longer in service.

PSE&G has a conditional ARO for legal obligations related to the removal of asbestos and underground storage tanks at certain industrial establishments, removal of wood poles, leases and licenses, removal of solar panels from leased property and the requirement to seal natural gas pipelines at all sources of gas when the pipelines are no longer in service. PSE&G did not record an ARO for its protected steel and poly-based natural gas transmission lines, as management believes that these categories of transmission lines have an indeterminable life.

The changes to the ARO liabilities for PSEG, Power and PSE&G during 2011 and 2012 are presented in the following table:

	PSEG	Power	PSE&G	Other
	Millions			
ARO Liability as of January 1, 2011	$ 461	$ 242	$ 216	$ 3
Liabilities Settled	(6)	(1)	(5)	—
Liabilities Incurred	2	—	2	—
Accretion Expense	19	18	—	1
Accretion Expense Deferred and Recovered in Rate Base (A)	13	—	13	—
ARO Liability as of December 21, 2011	**$ 489**	**$ 259**	**$ 226**	**$ 4**
Liabilities Settled	(5)	(1)	(5)	1
Liabilities Incurred	11	1	7	3
Accretion Expense	21	21	—	—
Accretion Expense Deferred and Recovered in Rate Base (A)	14	—	14	—
Revisions to Present Values of Estimated Cash Flows	97	89	8	—
ARO Liability as of December 31, 2012	**$ 627**	**$ 369**	**$ 250**	**$ 8**

(A) Not reflected as expense in Consolidated Statements of Operations

During 2012, Power recorded an increase in its ARO liabilities, primarily due to an increase in the estimated cost to decommission its nuclear power plants and increased accretion. The increase in the estimated costs to decommission Power's nuclear plants resulted primarily from the receipt of updated decommissioning cost studies in 2012 and the impact of lower discount rates. This change in the ARO did not result in any material impact in Power's Consolidated Statement of Operations.

Note 12. Pension, OPEB and Savings Plans

PSEG sponsors several qualified and nonqualified pension plans and OPEB plans covering PSEG’s and its participating affiliates’ current and former employees who meet certain eligibility criteria. Eligible employees of Power, PSE&G, Energy Holdings and Services participate in non-contributory pension and OPEB plans sponsored by PSEG and administered by Services. In addition, represented and nonrepresented employees are eligible for participation in PSEG’s two defined contribution plans described below.

PSEG, Power and PSE&G are required to record the under or over funded positions of their defined benefit pension and OPEB plans on their respective balance sheets. Such funding positions of each PSEG company are required to be measured as of the date of its respective year-end Consolidated Balance Sheets. For under funded plans, the liability is equal to the difference between the plan’s benefit obligation and the fair value of plan assets. For defined benefit pension plans, the benefit obligation is the projected benefit obligation. For OPEB plans, the benefit obligation is the accumulated postretirement benefit obligation. In addition, accounting guidance requires that the total unrecognized costs for defined benefit pension and OPEB plans be recorded as an after-tax charge to Accumulated Other Comprehensive Income (Loss), a separate component of Stockholders’ Equity. However, for PSE&G, because the amortization of the unrecognized costs is being collected from customers, the accumulated unrecognized costs are recorded as a Regulatory Asset. The unrecognized costs represent actuarial gains or losses, prior service costs and transition obligations arising from the adoption of the revised accounting guidance for pensions and OPEB, which had not been expensed.

For Power, the charge to Accumulated Other Comprehensive Income (Loss) is amortized and recorded as net periodic pension cost in the Consolidated Statements of Operations. For PSE&G, the Regulatory Asset is amortized and recorded as net periodic pension cost in the Consolidated Statements of Operations.

The following table provides a roll-forward of the changes in the benefit obligation and the fair value of plan assets during each of the two years in the periods ended December 31, 2012 and 2011. It also provides the funded status of the plans and the amounts recognized and amounts not recognized on the Consolidated Balance Sheets at the end of both years.

	Pension Benefits		Other Benefits	
	2012	2011	2012	2011
	Millions			
Change in Benefit Obligation:				
Benefit Obligation at Beginning of Year	$ 4,572	$ 4,353	$ 1,338	$ 1,162
Service Cost	101	92	17	14
Interest Cost	223	228	65	61
Actuarial (Gain) Loss	586	300	182	179
Gross Benefits Paid	(248)	(236)	(69)	(67)
Medicare Subsidy Receipts	—	—	5	6
Plan Amendments	—	(165)	—	(17)
Special Termination Benefits	1	—	—	—
Benefit Obligation at End of Year	**$ 5,235**	**$ 4,572**	**$ 1,538**	**$ 1,338**
Change in Plan Assets:				
Fair Value of Assets at Beginning of Year	$ 3,831	$ 3,555	$ 211	$ 195
Actual Return on Plan Assets	541	87	31	5
Employer Contributions	233	425	75	72
Gross Benefits Paid	(248)	(236)	(69)	(67)
Medicare Subsidy Receipts	—	—	5	6
Fair Value of Assets at End of Year	**$ 4,357**	**$ 3,831**	**$ 253**	**$ 211**
Funded Status:				
Funded Status (Plan Assets less Benefit Obligation)	**$ (878)**	**$ (741)**	**$ (1,285)**	**$ (1,127)**
Additional Amounts Recognized in the Consolidated Balance Sheets:				
Noncurrent Assets	$ 6	$ —	$ — —	$ —
Current Accrued Benefit Cost	(8)	(7)	—	—
Noncurrent Accrued Benefit Cost	(876)	(734)	(1,285)	(1,127)
Amounts Recognized	**$ (878)**	**$ (741)**	**$ (1,285)**	**$ (1,127)**
Additional Amounts Recognized in Accumulated Other Comprehensive Income (Loss), Regulated Assets and Deferred Assets (A):				
Net Transition Obligation	$ —	$ —	$ —	$ 2
Prior Service Cost	(139)	(158)	(67)	(81)
Net Actuarial Loss	2,174	1,991	527	390
Total	**$ 2,035**	**$ 1,833**	**$ 460**	**$ 311**

(A) Includes $827 million ($485 million, after-tax) and $745 million ($438 million, after-tax) in Accumulated Other Comprehensive Loss related to Pension and OPEB as of December 31, 2012 and 2011, respectively.

The pension benefits table above provides information relating to the funded status of all qualified and nonqualified pension plans and OPEB plans on an aggregate basis. As of December 31, 2012, PSEG had funded approximately 83% of its projected benefit obligation. This percentage does not include $ 185 million of assets in the Rabbi Trust as of December 31, 2012, which are used to partially fund the nonqualified pension plans. The fair values of the Rabbi Trust assets are included in the Consolidated Balance Sheets.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Accumulated Benefit Obligation

The accumulated benefit obligation for all PSEG's defined benefit pension plans was $ 4.9 billion as of December 31, 2012 and $4.3 billion as of December 31, 2011.

The following table provides the components of net periodic benefit cost for the years ended December 31, 2012, 2011 and 2010.

	Pension Benefits Years Ended December 31,			Other Benefits Years Ended December 31,		
	2012	2011	2010	2012	2011	2010
	Millions					
Components of Net Periodic Benefit Cost:						
Service Cost	$ 101	$ 92	$ 87	$ 17	$ 14	$ 16
Interest Cost	223	228	231	65	61	72
Expected Return on Plan Assets	(306)	(334)	(266)	(17)	(18)	(14)
Amortization of Net						
Transition Obligation	—	—	—	2	4	27
Prior Service Cost	(18)	(11)	—	(14)	(13)	13
Actuarial Loss	167	119	122	31	14	8
Net Periodic Benefit Cost	**$ 167**	**$ 94**	**$ 174**	**$ 84**	**$ 62**	**$ 122**
Special Termination Benefits	1	—	—	—	—	—
Effect of Regulatory Asset	—	—	—	19	19	19
Total Benefit Costs, Including Effect of Regulatory Asset	**$ 168**	**$ 94**	**$ 174**	**$ 103**	**$ 81**	**$ 141**

Pension costs and OPEB costs for PSEG, Power and PSE&G are detailed as follows:

	Pension Benefits Years Ended December 31,			Other Benefits Years Ended December 31,		
	2012	2011	2010	2012	2011	2010
	Millions					
Power	$ 52	$ 29	$ 54	$ 18	$ 12	$ 17
PSE&G	97	51	97	82	67	120
Other	19	14	23	3	2	4
Total Benefit Costs	**$ 168**	**$ 94**	**$ 174**	**$ 103**	**$ 81**	**$ 141**

The following table provides the pre-tax changes recognized in Accumulated Other Comprehensive Income (Loss), Regulatory Assets and Deferred Assets:

	Pension		OPEB	
	2012	2011	2012	2011
	Millions			
Net Actuarial (Gain) Loss in Current Period	$ 350	$ 547	$ 169	$ 192
Amortization of Net Actuarial Gain (Loss)	(167)	(119)	(32)	(14)
Prior Service Credit in Current Period	—	(165)	—	(17)
Amortization of Prior Service Credit	19	11	14	13
Amortization of Transition Asset	—	—	(2)	(4)
Total	**$ 202**	**$ 274**	**$ 149**	**$ 170**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Amounts that are expected to be amortized from Accumulated Other Comprehensive Loss, Regulatory Assets and Deferred Assets into Net Periodic Benefit Cost in 2013 are as follows:

	Pension Benefits 2013	Other Benefits 2013
	Millions	
Actuarial (Gain) Loss	$ 188	$ 43
Prior Service Cost	$ (19)	$ (14)

The following assumptions were used to determine the benefit obligations and net periodic benefit costs:

	Pension Benefits			Other Benefits		
	2012	2011	2010	2012	2011	2010
Weighted-Average Assumptions Used to Determine Benefit Obligations as of December 31:						
Discount Rate	4.20%	5.00%	5.51%	4.20%	5.00%	5.50%
Rate of Compensation Increase	4.61%	4.61%	4.61%	4.61%	4.61%	4.61%
Weighted-Average Assumptions Used to Determine Net Periodic Benefit Cost for Years Ended December 31:						
Discount Rate	5.00%	5.40%	5.91%	5.00%	5.38%	5.90%
Expected Return on Plan Assets	8.00%	8.50%	8.50%	8.00%	8.50%	8.50%
Rate of Compensation Increase	4.61%	4.61%	4.61%	4.61%	4.61%	4.61%
Assumed Health Care Cost Trend Rates as of December 31:						
Administrative Expense				3.00%	5.00%	5.00%
Dental Costs				6.00%	6.00%	6.00%
Pre-65 Medical Costs						
Immediate Rate				8.88%	8.00%	7.75%
Ultimate Rate				5.00%	5.00%	5.00%
Year Ultimate Rate Reached				2023	2016	2015
Post-65 Medical Costs						
Immediate Rate				7.98%	8.25%	8.75%
Ultimate Rate				5.00%	5.00%	5.00%
Year Ultimate Rate Reached				2019	2017	2016
Effect of a 1% Increase in the Assumed Rate of Increase in Health Care Benefit Costs:						
					Millions	
Total of Service Cost and Interest Cost				$ 12	$ 11	$ 10
Postretirement Benefit Obligation				$ 180	$ 155	$ 122
Effect of a 1% Decrease in the Assumed Rate of Increase in Health Care Benefit Costs:						
Total of Service Cost and Interest Cost				$ (9)	$ (9)	$ (8)
Postretirement Benefit Obligation				$ (149)	$ (128)	$ (102)

Plan Assets

All the investments of pension plans and OPEB plans are held in a trust account by the trustee and consist of an undivided interest in an investment account of the Master Trust. The investments in the pension and OPEB plans are measured at fair value within a hierarchy that prioritizes the inputs to fair value measurements into three levels. See Note 17. Fair Value Measurements for more information on fair value guidance. Use of the Master Trust permits the commingling of pension plan assets and OPEB plan assets for investment and administrative purposes. Although assets of both plans are commingled in the Master Trust, the Trustee maintains supporting records for the purpose of allocating the net gain or loss of the investment account to the respective participating plans. The net investment income of the investment assets is allocated by the Trustee to each participating plan based on the relationship of the interest of each plan to the total of the interests of the participating plans. As of December 31, 2012, the pension plan interest and OPEB plan interest in such assets of the Master Trust were approximately 94% and 6%, respectively.

The following tables present information about the investments measured at fair value on a recurring basis as of December 31, 2012 and 2011, including the fair value measurements and the levels of inputs used in determining those fair values.

	Recurring Fair Value Measurements as of December 31, 2012			
Description	**Total**	**Quoted Market Prices for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
	Millions			
Temporary Investment Funds (A)	$ 67	$ —	$ 67	$ —
Common Stocks (B)				
Commingled—United States	1,928	1,928	—	—
Commingled—International	839	839	—	—
Other	431	431	—	—
Bonds (C)				
Government (United States & Foreign)	623	—	623	—
Other	691	—	691	—
Private Equity (E)	31	—	—	31
Total	**$ 4,610**	**$ 3,198**	**$ 1,381**	**$ 31**

	Recurring Fair Value Measurements as of December 31, 2011			
Description	**Total**	**Quoted Market Prices for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
	Millions			
Temporary Investment Funds (A)	$ 32	$ —	$ 32	$ —
Common Stocks (B)				
Commingled—United States	1,653	1,653	—	—
Commingled—International	603	603	—	—
Other	356	356	—	—
Bonds (C)				
Government (United States & Foreign)	662	—	662	—
Other	663	—	663	—
Pooled Real Estate (D)	36	—	—	36
Private Equity (E)	37	—	—	37
Total	**$ 4,042**	**$ 2,612**	**$ 1,357**	**$ 73**

(A) Certain temporary investment funds are valued using inputs such as time-to-maturity, coupon rate, quality rating and current yield (primarily Level 2).

(B) Wherever possible, fair values of equity investments in stocks and in commingled funds are derived from quoted market prices as substantially all of these instruments have active markets (primarily Level 1). Most investments in stocks are priced utilizing the principal market close price or in some cases midpoint, bid or ask price.

(C) Investments in fixed income securities including bond funds are priced using an evaluated pricing approach or the most recent exchange or quoted bid (primarily Level 2).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(D) The fair value of real estate investments is based on annual independent appraisals. The investments are also valued internally every quarter by the investment managers based on significant changes in property operations and market conditions (primarily Level 3).

(E) Limited partnership interests in private equity funds are valued using significant unobservable inputs as there is little, if any, market activity. In addition, there may be transfer restrictions on private equity securities. The process for determining the fair value of such securities relied on commonly accepted valuation techniques, including the use of earnings multiples based on comparable public securities, industry-specific non-earnings-based multiples and discounted cash flow models. These inputs require significant management judgment or estimation (primarily Level 3).

Reconciliations of the beginning and ending balances of the Pension and OPEB Plans' Level 3 assets for the years ended December 31, 2012 and 2011 follow:

	Balance as of January 1, 2012	Purchases/ (Sales)	Transfer In/ (Out)	Actual Return on Asset Sales	Actual Return on Assets Still Held	Balance as of December 31, 2012
			Millions			
Pooled Real Estate	$ 36	$ (38)	$ —	$ 2	$ —	$ —
Private Equity	$ 37	$ (6)	$ —	$ 5	$ (5)	$ 31

	Balance as of January 1, 2011	Purchases/ (Sales)	Transfer In/ (Out) (A)	Actual Return on Asset Sales	Actual Return on Assets Still Held	Balance as of December 31, 2011
			Millions			
Temporary Investment Funds	$ 23	$ —	$ (23)	$ —	$ —	$ —
Commingled Bonds —United States	$ 8	$ (8)	$ —	$ —	$ —	$ —
Pooled Real Estate	$ 48	$ (18)	$ —	$ 1	$ 5	$ 36
Private Equity	$ 38	$ (5)	$ —	$ 7	$ (3)	$ 37

(A) During the year ended December 31, 2011, $23 million of the temporary investment funds in the Pension and OPEB Fund were transferred from Level 3 to Level 2, due to more observable pricing for the underlying securities. As per PSEG's policy, this transfer was recognized as of the beginning of the first quarter (i.e. the quarter in which the transfer occurred).

The following table provides the percentage of fair value of total plan assets for each major category of plan assets held for the qualified pension and OPEB plans as of the measurement date, December 31:

	As of December 31,	
Investments	**2012**	**2011**
Equity Securities	69%	64%
Fixed Income Securities	29	33
Real Estate Assets	—	1
Other Investments	2	2
Total Percentage	**100%**	**100%**

PSEG utilizes forecasted returns, risk, and correlation of all asset classes in order to develop a portfolio designed to produce the maximum return opportunity per unit of risk. In 2011, PSEG completed its latest asset/liability study. The results from the study indicated that a long-term target asset allocation of 70% equities and 30% fixed income is consistent with the funds' financial objectives. Derivative financial instruments are used by the plans' investment managers primarily to rebalance the fixed income/equity allocation of the portfolio and hedge the currency risk component of foreign investments. The expected long-term rate of return on plan assets was 8.00% as of December 31, 2012 and will remain unchanged for 2013. This expected return was determined based on the study discussed above and considered the plans' historical annualized rate of return since inception, which was an annualized return of 9.3%.

Plan Contributions

PSEG may contribute up to $145 million into its pension plans and $14 million into its OPEB plan for calendar year 2013.

Estimated Future Benefit Payments

The following pension benefit and postretirement benefit payments are expected to be paid to plan participants.

Year	Pension Benefits	Other Benefits
	Millions	
2013	$ 254	$ 79
2014	260	80
2015	267	82
2016	274	84
2017	284	85
2018-2022	1,592	459
Total	**$ 2,931**	**$ 869**

401(k) Plans

PSEG sponsors two 401(k) plans, which are Employee Retirement Income Security Act defined contribution retirement plans. Eligible represented employees of PSEG's subsidiaries participate in the PSEG Employee Savings Plan (Savings Plan), while eligible non-represented employees of PSEG's subsidiaries participate in the PSEG Thrift and Tax-Deferred Savings Plan (Thrift Plan). Eligible employees may contribute up to 50% of their compensation to these plans. PSEG matches 50% of such employee contributions up to 7% of pay for Savings Plan participants and up to 8% of pay for Thrift Plan participants.

The amount paid for employer matching contributions to the plans for PSEG, Power and PSE&G are detailed as follows:

	Thrift Plan and Savings Plan		
	Years Ended December 31,		
	2012	**2011**	**2010**
	Millions		
Power	$ 10	$ 8	$ 5
PSE&G	18	14	9
Other	4	2	3
Total Employer Matching Contributions	**$ 32**	**$ 24**	**$ 17**

Note 13. Commitments and Contingent Liabilities

Guaranteed Obligations

Power's activities primarily involve the purchase and sale of energy and related products under transportation, physical, financial and forward contracts at fixed and variable prices. These transactions are with numerous counterparties and brokers that may require cash, cash-related instruments or guarantees.

Power has unconditionally guaranteed payments to counterparties by its subsidiaries in commodity-related transactions in order to

- support current exposure, interest and other costs on sums due and payable in the ordinary course of business, and
- obtain credit.

Under these agreements, guarantees cover lines of credit between entities and are often reciprocal in nature. The exposure between counterparties can move in either direction.

In order for Power to incur a liability for the face value of the outstanding guarantees, its subsidiaries would have to

- fully utilize the credit granted to them by every counterparty to whom Power has provided a guarantee, and
- all of the related contracts would have to be "out-of-the-money" (if the contracts are terminated, Power would owe money to the counterparties).

Power believes the probability of this result is unlikely. For this reason, Power believes that the current exposure at any point in time is a more meaningful representation of the potential liability under these guarantees. This current exposure consists of the net of accounts receivable and accounts payable and the forward value on open positions, less any collateral posted.

Power is subject to

- counterparty collateral calls related to commodity contracts, and
- certain creditworthiness standards as guarantor under performance guarantees of its subsidiaries.

Changes in commodity prices can have a material impact on collateral requirements under such contracts, which are posted and received primarily in the form of cash and letters of credit. Power also routinely enters into futures and options transactions for electricity and natural gas as part of its operations. These futures contracts usually require a cash margin deposit with brokers, which can change based on market movement and in accordance with exchange rules.

In addition to the guarantees discussed above, Power has also provided payment guarantees to third parties on behalf of its affiliated companies. These guarantees support various other non-commodity related contractual obligations.

The face value of outstanding guarantees, current exposure and margin positions as of December 31, 2012 and 2011 are shown below:

	As of December 31, 2012		As of December 31, 2011	
	Millions			
Face Value of Outstanding Guarantees	$	1,508	$	1,756
Exposure under Current Guarantees	$	226	$	315
Letters of Credit Margin Posted	$	124	$	135
Letters of Credit Margin Received	$	69	$	91
Cash Deposited and Received				
Counterparty Cash Margin Deposited	$	15	$	20
Counterparty Cash Margin Received	$	(4)	$	(7)
Net Broker Balance Deposited (Received)	$	26	$	(92)
In the Event Power were to Lose its Investment Grade Rating:				
Additional Collateral that could be Required	$	654	$	812
Liquidity Available under PSEG's and Power's Credit Facilities to Post Collateral	$	3,531	$	3,415
Additional Amounts Posted				
Other Letters of Credit	$	45	$	52

As part of determining credit exposure, Power nets receivables and payables with the corresponding net energy contract balances. See Note 16. Financial Risk Management Activities for further discussion. In accordance with PSEG's accounting policy, where it is applicable, cash (received)/deposited is allocated against derivative asset and liability positions with the same counterparty on the face of the Balance Sheet. The remaining balances of net cash (received)/deposited after allocation are generally included in Accounts Payable and Receivable, respectively.

In the event of a deterioration of Power's credit rating to below investment grade, which would represent a two level downgrade from its current S&P ratings or a three level downgrade from its current Moody's and Fitch ratings, many of these agreements allow the counterparty to demand further performance assurance. See table above.

During 2012, the SEC and the Commodity Futures Trading Commission (CFTC) continued efforts to implement new rules to enact stricter regulation over swaps and derivatives. The CFTC has issued Final Rules regarding the definition of a swap dealer

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

and the definition of a swap. However, in September 2012, a federal court vacated the CFTC's rule on monitoring of position limits for several commodities, including natural gas, thereby indefinitely delaying the effectiveness of these position limits rules. The CFTC has appealed the court's decision to vacate the position limits rules. PSEG is carefully monitoring all of these new rules as they are issued to analyze the potential impact on its swap and derivatives transactions, including any potential increase in its collateral requirements.

In addition to amounts for outstanding guarantees, current exposure and margin positions, Power had posted letters of credit to support various other non-energy contractual and environmental obligations. See table above.

Environmental Matters

Passaic River

Historic operations of PSEG companies and the operations of hundreds of other companies along the Passaic and Hackensack Rivers are alleged by Federal and State agencies to have discharged substantial contamination into the Passaic River/Newark Bay Complex.

Federal Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA)

The EPA has determined that an eight-mile stretch of the Passaic River in the area of Newark, New Jersey is a “facility” within the meaning of that term under CERCLA. The EPA has determined the need to perform a study of the entire 17-mile tidal reach of the lower Passaic River.

PSE&G and certain of its predecessors conducted operations at properties in this area on or adjacent to the Passaic River. The properties included one operating electric generating station (Essex Site), which was transferred to Power, one former generating station and four former manufactured gas plant (MGP) sites. When the Essex Site was transferred from PSE&G to Power, PSE&G obtained releases and indemnities for liabilities arising out of the former Essex generating station and Power assumed any environmental liabilities.

The EPA believes that certain hazardous substances were released from the Essex Site and one of PSE&G’s former MGP locations (Harrison Site). In 2006, the EPA notified the potentially responsible parties (PRPs) that the cost of its Remedial Investigation and Feasibility Study (RI/FS) would greatly exceed the original estimated cost of $20 million. The total cost of the RI/FS is now estimated at approximately $110 million. Seventy-three PRPs, including Power and PSE&G, agreed to assume responsibility for the RI/FS and formed the Cooperating Parties Group (CPG) to divide the associated costs according to a mutually agreed upon formula. The CPG group, currently 70 members, is presently executing the RI/FS. Approximately five percent of the RI/FS costs are attributable to PSE&G’s former MGP sites and approximately one percent to Power’s generating stations. Power has provided notice to insurers concerning this potential claim.

In 2007, the EPA released a draft “Focused Feasibility Study” (FFS) that proposed six options to address the contamination cleanup of the lower eight miles of the Passaic River. The EPA estimated costs for the proposed remedy range from $1.3 billion to $3.7 billion. The work contemplated by the FFS is not subject to the cost sharing agreement discussed above. The EPA's revised proposed FFS may be released for public comment as early as April 2013.

In June 2008, an agreement was announced between the EPA and Tierra Solutions, Inc. and Maxus Energy Corporation (Tierra/Maxus) for removal of a portion of the contaminated sediment in the Passaic River at an estimated cost of $80 million. Phase I of the removal work has been completed. Phase II is contingent on the approval of an appropriate sediment disposal facility. Tierra/Maxus have reserved their rights to seek contribution for the removal costs from the other PRPs, including Power and PSE&G.

The EPA has advised that the levels of contaminants at Passaic River mile 10.9 will require removal in advance of the completion of the RI/FS. The CPG members, with the exception of Tierra/Maxus, which are no longer members, have agreed to fund the removal, currently estimated at approximately $30 million. PSEG’s share of that effort is approximately three percent.

Except for the Passaic River 10.9 mile removal, Power and PSE&G are unable to estimate their portion of the possible loss or range of loss related to the Passaic River matters.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

New Jersey Spill Compensation and Control Act (Spill Act)

In 2005, the New Jersey Department of Environmental Protection (NJDEP) filed suit against a PRP and its related companies in the New Jersey Superior Court seeking damages and reimbursement for costs expended by the State of New Jersey to address the effects of the PRP's discharge of hazardous substances into both the Passaic River and the balance of the Newark Bay Complex. Power and PSE&G are alleged to have owned, operated or contributed hazardous substances to a total of 11 sites or facilities that impacted these water bodies. In February 2009, third party complaints were filed against some 320 third party defendants, including Power and PSE&G, claiming that each of the third party defendants is responsible for its proportionate share of the clean-up costs for the hazardous substances it allegedly discharged into the Passaic River and the Newark Bay Complex. The third party complaints seek statutory contribution and contribution under the Spill Act to recover past and future removal costs and damages. Power and PSE&G filed answers to the complaints in June 2010. A special master for discovery has been appointed by the court and document production has commenced. In October 2012, the Court issued a 90 day stay of discovery for the third party defendants to explore a possible settlement of this matter with the State of New Jersey. The original stay has been extended, most recently until March 23, 2013, and is likely to be extended again, to permit the parties to continue forward with a settlement process. Power and PSE&G believe they have good and valid defenses to the allegations contained in the third party complaints and will vigorously assert those defenses. Power and PSE&G are unable to estimate their portion of the possible loss or range of loss related to this matter.

Natural Resource Damage Claims

In 2003, the NJDEP directed PSEG, PSE&G and 56 other PRPs to arrange for a natural resource damage assessment and interim compensatory restoration of natural resource injuries along the lower Passaic River and its tributaries pursuant to the Spill Act. The NJDEP alleged that hazardous substances had been discharged from the Essex Site and the Harrison Site. The NJDEP estimated the cost of interim natural resource injury restoration activities along the lower Passaic River at approximately $950 million. In 2007, agencies of the United States Department of Commerce and the United States Department of the Interior sent letters to PSE&G and other PRPs inviting participation in an assessment of injuries to natural resources that the agencies intended to perform. In 2008, PSEG and a number of other PRPs agreed to share certain immaterial costs the trustees have incurred and will incur going forward, and to work with the trustees to explore whether some or all of the trustees' claims can be resolved in a cooperative fashion. That effort is continuing. PSE&G is unable to estimate its portion of the possible loss or range of loss related to this matter.

Newark Bay Study Area

The EPA has established the Newark Bay Study Area, which it defines as Newark Bay and portions of the Hackensack River, the Arthur Kill and the Kill Van Kull. In August 2006, the EPA sent PSEG and 11 other entities notices that it considered each of the entities to be a PRP with respect to contamination in the Study Area. The notice letter requested that the PRPs fund an EPA-approved study in the Newark Bay Study Area and encouraged the PRPs to contact Occidental Chemical Corporation (OCC) to discuss participating in the Remedial Investigation/Feasibility Study that OCC was conducting. The notice stated the EPA's belief that hazardous substances were released from sites owned by PSEG companies and located on the Hackensack River, including two operating electric generating stations (Hudson and Kearny sites) and one former MGP site. PSEG has participated in and partially funded the second phase of this study. Notices to fund the next phase of the study have been received but it is uncertain at this time whether the PSEG companies will consent to fund the third phase. Power and PSE&G are unable to estimate their portion of the possible loss or range of loss related to this matter.

MGP Remediation Program

PSE&G is working with the NJDEP to assess, investigate and remediate environmental conditions at its former MGP sites. To date, 38 sites requiring some level of remedial action have been identified. Based on its current studies, PSE&G has determined that the estimated cost to remediate all MGP sites to completion could range between $588 million and $675 million through 2021. Since no amount within the range is considered to be most likely, PSE&G has recorded a liability of $588 million as of December 31, 2012. Of this amount, $113 million was recorded in Other Current Liabilities and $475 million was reflected as Environmental Costs in Noncurrent Liabilities. PSE&G has recorded a $588 million Regulatory Asset with respect to these costs. PSE&G periodically updates its studies taking into account any new regulations or new information which could impact future remediation costs and adjusts its recorded liability accordingly.

Prevention of Significant Deterioration (PSD)/New Source Review (NSR)

The PSD/NSR regulations, promulgated under the Clean Air Act (CAA), require major sources of certain air pollutants to obtain permits, install pollution control technology and obtain offsets, in some circumstances, when those sources undergo a "major modification," as defined in the regulations. The federal government may order companies that are not in compliance with the PSD/NSR regulations to install the best available control technology at the affected plants and to pay monetary penalties ranging from $25,000 to $37,500 per day for each violation, depending upon when the alleged violation occurred.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In 2009, the EPA issued a notice of violation to Power and the other owners of the Keystone coal-fired plant in Pennsylvania, alleging, among other things, that various capital improvement projects were completed at the plant which are considered modifications (or major modifications) causing significant net emission increases of PSD/NSR air pollutants, beginning in 1985 for Keystone Unit 1 and in 1984 for Keystone Unit 2. The notice of violation states that none of these modifications underwent PSD/NSR permitting process prior to being put into service, which the EPA alleges was required under the CAA. The notice of violation states that the EPA may issue an order requiring compliance with the relevant CAA provisions and may seek injunctive relief and/or civil penalties. Power owns approximately 23% of the plant. Power cannot predict the outcome of this matter.

Hazardous Air Pollutants Regulation

In accordance with a ruling of the U.S. Court of Appeals of the District of Columbia (Court of Appeals), the EPA published a Maximum Achievable Control Technology (MACT) regulation on February 16, 2012. These Mercury Air Toxics Standards (MATS) are scheduled to go into effect on April 16, 2015 and establish allowable emission levels for mercury as well as other hazardous air pollutants pursuant to the CAA. In February 2012, members of the electric generating industry filed a petition challenging the existing source National Emission Standard for Hazardous Air Pollutants (NESHAP), new source NESHAP and the New Source Performance Standard (NSPS). In March 2012, PSEG filed a motion to intervene with the Court of Appeals in support of the EPA's implementation of MATS. Litigation of these matters remains pending and the impact on the implementation schedule is unknown at this time.

Power believes that it will not be necessary to install any material controls at its other New Jersey facilities. Additional controls may be necessary at Power's Bridgeport Harbor coal-fired unit at an immaterial cost. In December 2011, to comply with the MACT regulators, a decision was reached to upgrade the previously planned two flue gas desulfurization scrubbers and install Selective Catalytic Reduction (SCR) systems at Power's jointly owned coal-fired generating facility at Conemaugh in Pennsylvania. This installation is expected to be completed in the first quarter of 2015. Power's share of this investment is approximately $147 million.

NOx Regulation

In April 2009, the NJDEP finalized revisions to NO_x emission control regulations that impose new NO_x emission reduction requirements and limits for New Jersey fossil fuel-fired electric generation units. The rule has an impact on Power's generation fleet, as it imposes NO_x emissions limits that will require capital investment for controls or the retirement of up to 86 combustion turbines (approximately 1,750 MW) and four older New Jersey steam electric generation units (approximately 400 MW) by May 30, 2015. Retirement notifications for the combustion turbines, except for Salem Unit 3, have been filed with PJM. The Salem Unit 3 combustion turbine (38 MW) will be transitioning to an emergency generator. Evaluations are ongoing for the steam electric generation units.

Under current Connecticut regulations, Power's Bridgeport and New Haven facilities have been utilizing Discrete Emission Reduction Credits (DERCs) to comply with certain NO_x emission limitations that were incorporated into the facilities' operating permits. In 2010, Power negotiated new agreements with the State of Connecticut extending the continued use of DERCs for certain emission units and equipment until May 31, 2014.

Clean Water Act Permit Renewals

Pursuant to the Federal Water Pollution Control Act (FWPCA), National Pollutant Discharge Elimination System (NPDES) permits expire within five years of their effective date. In order to renew these permits, but allow a plant to continue to operate, an owner or operator must file a permit application no later than six months prior to expiration of the permit. States with delegated federal authority for this program manage these permits. The New Jersey Department of Environmental Protection manages the permits under the New Jersey Pollutant Discharge Elimination System (NJPDES) program. Connecticut and New York also have permits to manage their respective pollutant discharge elimination system programs.

One of the most significant NJPDES permits governing cooling water intake structures at Power is for Salem. In 2001, the NJDEP issued a renewed NJPDES permit for Salem, expiring in July 2006, allowing for the continued operation of Salem with its existing cooling water intake system. In February 2006, Power filed with the NJDEP a renewal application allowing Salem to continue operating under its existing NJPDES permit until a new permit is issued. Power prepared its renewal application in accordance with the FWPCA Section 316(b) and the 316(b) rules published in 2004.

As a result of several legal challenges to the 2004 316(b) rule by certain northeast states, environmentalists and industry groups, the rule has been suspended and has been returned to the EPA to be consistent with a 2009 United States Supreme Court decision which concluded that the EPA could rely upon cost-benefit analysis in setting the national performance standards and in providing for cost-benefit variances from those standards as part of the Phase II regulations.

In late 2010, the EPA entered into a settlement agreement with environmental groups that established a schedule to develop a new 316(b) rule by July 27, 2012. In April 2011, the EPA published a new proposed rule which did not establish any particular technology as the best technology available (e.g. closed cycle cooling). Instead, the proposed rule established marine life mortality standards for existing cooling water intake structures with a design flow of more than two million gallons per day. In June 2012, the EPA posted two Notices of Data Availability (NODA) requesting comment on aspects of the April 2011 proposed rule. In July 2012, PSEG and industry trade associations submitted comments on both NODAs and the EPA and environmental groups agreed to delay the deadline for finalization of the Rule to June 27, 2013 to allow for more time to address public comments and analyze data submitted in response to the NODAs.

Power is unable to predict the outcome of this proposed rulemaking, the final form that the proposed regulations may take and the effect, if any, that they may have on its future capital requirements, financial condition, results of operations or cash flows. The results of further proceedings on this matter could have a material impact on Power's ability to renew permits at its larger once-through cooled plants, including Salem, Hudson, Mercer, Bridgeport and possibly Sewaren and New Haven, without making significant upgrades to existing intake structures and cooling systems. The costs of those upgrades to one or more of Power's once-through cooled plants would be material, and would require economic review to determine whether to continue operations at these facilities. For example, in Power's application to renew its Salem permit, filed with the NJDEP in February 2006, the estimated costs for adding cooling towers for Salem were approximately $1 billion, of which Power's share would have been approximately $575 million. These cost estimates have not been updated. Currently, potential costs associated with any closed cycle cooling requirements are not included in Power's forecasted capital expenditures.

Capital Expenditures

The construction programs of PSEG and its subsidiaries are currently estimated to include a base level total investment of approximately $6.1 billion for the three years ended 2015. The three year capital expenditures for PSEG, Power and PSE&G are as follows:

	2013	2014	2015
		Millions	
Power	$ 400	$ 365	$ 305
PSE&G	2,040	1,680	1,180
Other	95	40	30
Total PSEG	**$ 2,535**	**$ 2,085**	**$ 1,515**

Power's projected capital expenditures include baseline maintenance, investments in response to environmental or legal mandates and nuclear expansion. PSE&G's projections include material additions and replacements in its transmission and distribution systems to meet expected growth and manage reliability.

Basic Generation Service (BGS) and Basic Gas Supply Service (BGSS)

PSE&G obtains its electric supply requirements for customers who do not purchase electric supply from third party suppliers through the annual New Jersey BGS auctions. Pursuant to applicable BPU rules, PSE&G enters into the Supplier Master Agreement with the winners of these BGS auctions following the BPU's approval of the auction results. PSE&G has entered into contracts with Power, as well as with other winning BGS suppliers, to purchase BGS for PSE&G's load requirements. The winners of the auction (including Power) are responsible for fulfilling all the requirements of a PJM Load Serving Entity including the provision of capacity, energy, ancillary services, transmission and any other services required by PJM. BGS suppliers assume all volume risk and customer migration risk and must satisfy New Jersey's renewable portfolio standards.

Power seeks to mitigate volatility in its results by contracting in advance for the sale of most of its anticipated electric output as well as its anticipated fuel needs. As part of its objective, Power has entered into contracts to directly supply PSE&G and other New Jersey electric distribution companies (EDCs) with a portion of their respective BGS requirements through the New Jersey BGS auction process, described above.

PSE&G has contracted for its anticipated BGS-Fixed Price eligible load, as follows:

	Auction Year			
	2010	2011	2012	2013
36-Month Terms Ending	May 2013	May 2014	May 2015	May 2016 (A)
Load (MW)	2,800	2,800	2,900	2,800
$ per kWh	0.09577	0.09430	0.08388	0.09218

(A) Prices set in the 2013 BGS auction will become effective on June 1, 2013 when the 2010 BGS auction agreements expire.

PSE&G has a full requirements contract with Power to meet the gas supply requirements of PSE&G's gas customers. Power has entered into hedges for a portion of these anticipated BGSS obligations, as permitted by the BPU. The BPU permits PSE&G to recover the cost of gas hedging up to 115 billion cubic feet or 80% of its residential gas supply annual requirements through the BGSS tariff. Current plans call for Power to hedge on behalf of PSE&G approximately 70 billion cubic feet or 50% of its residential gas supply annual requirements. For additional information, see Note 23. Related-Party Transactions.

Minimum Fuel Purchase Requirements

Power has various long-term fuel purchase commitments for coal through 2017 to support its fossil generation stations and for supply of nuclear fuel for the Salem, Hope Creek and Peach Bottom nuclear generating stations and for firm transportation and storage capacity for natural gas.

Power's strategy is to maintain certain levels of uranium and to make periodic purchases to support such levels. As such, the commitments referred to in the following table may include estimated quantities to be purchased that deviate from contractual nominal quantities. Power's nuclear fuel commitments cover approximately 100% of its estimated uranium, enrichment and fabrication requirements through 2015 and a portion through 2017 at Salem, Hope Creek and Peach Bottom.

Power's various multi-year contracts for firm transportation and storage capacity for natural gas are primarily used to meet its gas supply obligations to PSE&G. These purchase obligations are consistent with Power's strategy to enter into contracts for its fuel supply in comparable volumes to its sales contracts.

As of December 31, 2012, the total minimum purchase requirements included in these commitments were as follows:

Fuel Type	Power's Share of Commitments through 2017	
	Millions	
Nuclear Fuel		
Uranium	$	518
Enrichment	$	453
Fabrication	$	146
Natural Gas	$	939
Coal	$	555

Regulatory Proceedings

New Jersey Clean Energy Program

In 2008, the BPU approved funding requirements for each New Jersey EDC applicable to its Renewable Energy and Energy Efficiency programs for the years 2009 to 2012. In late 2012, the BPU approved additional funding requirements for these programs for the first half of 2013. The aggregate funding for the first half of 2013 is $195 million. PSE&G's share is $153 million which it recorded as a current liability as of December 31, 2012. The liability is reduced as normal payments are made. The liability has been recorded with an offsetting Regulatory Asset, since the costs associated with this program are recovered from PSE&G ratepayers through the SBC.

The BPU has started a new Comprehensive Resource Analysis proceeding to determine SBC funding for the years 2013-2016. The proceeding has no impact on current SBC assessments.

Long-Term Capacity Agreement Pilot Program (LCAPP)

In 2011, New Jersey enacted the LCAPP Act that resulted in the selection of three generators to build a total of approximately 2,000 MW of new combined-cycle generating facilities located in New Jersey. Each of the New Jersey EDCs, including PSE&G, was directed to execute a standard offer capacity agreement (SOCA) with the three selected generators, but did so under protest preserving their legal rights. The SOCA provides for the EDCs to guarantee specified annual capacity payments to the generators subject to the terms and conditions of the agreement. Legal challenges to the BPU's implementation of the LCAPP Act were filed in New Jersey appellate court and this appeal is pending. In addition, the LCAPP Act itself has been challenged on constitutional grounds in federal court.

In May 2012, two of the three generators cleared the Reliability Pricing Model auction for the 2015/2016 delivery year in the aggregate notional amount of approximately 1,300 MW of installed capacity. SOCA payments are for a 15 year term, which are scheduled to commence for one of the generators in the 2015/2016 delivery year and for the other generator in the 2016/2017 delivery year. Based upon the expected percentage of state load that PSE&G will be serving during the term of these contracts, PSE&G would be responsible for approximately 52% or 676 MW of this amount.

Under current accounting guidance, the current estimated fair value of the SOCAs is recorded as a Derivative Asset or Liability with an offsetting Regulatory Asset or Liability on PSE&G's Consolidated Balance Sheets. See Note 17. Fair Value Measurements for additional information.

Superstorm Sandy

In late October 2012, Superstorm Sandy caused severe damage to PSE&G's transmission and distribution system throughout its service territory as well as to some of Power's generation infrastructure in the northern part of New Jersey. Strong winds resulted in a storm surge that caused damage to switching stations, substations and generating infrastructure.

As of December 31, 2012, Power had incurred approximately $85 million in costs related to Superstorm Sandy, primarily comprised of repairs at certain generating stations and damage to materials and supplies, both at our fossil fleet. All the costs were recognized in Operation and Maintenance Expense, offset by $19 million of a pending future recovery of insurance proceeds. Power expects that it will incur additional future costs, primarily relating to repairs to, and replacement of, equipment and property, which could be material.

As of December 31, 2012, PSE&G had incurred approximately $295 million of costs to restore service to PSE&G's distribution and transmission systems and $5 million to repair its infrastructure and return it to pre-storm conditions. Of the costs incurred, approximately $40 million was recognized in Operation and Maintenance Expense, $75 million was recorded as Property, Plant and Equipment and $180 million was recorded as a Regulatory Asset because such costs were deferred as approved by the BPU under an Order received in December 2012. PSE&G recognized $6 million of insurance proceeds.

PSEG maintains insurance coverage against loss or damage to plants and certain properties, subject to certain exceptions, to the extent such property is usually insured and insurance is available at a reasonable cost. PSEG is seeking recovery from its insurers for the property damage, above its self-insured retentions; however, no assurances can be given relative to the timing or amount of such recovery. PSEG received an authorization for $25 million from its insurance carriers as an advance payment which was recorded in 2012. PSEG believes that additional insurance recoveries are not estimable as of December 31, 2012. PSEG is at the early stages of documenting its insurance claim which then will need to be submitted to and reviewed by its insurers. PSEG does not believe that it has a basis for estimating additional probable insurance recoveries at this time.

Leveraged Lease Investments

On January 31, 2012, PSEG entered into a specific matter closing agreement with the Internal Revenue Service (IRS) settling all matters related to cross border lease transactions. This agreement settles the leasing dispute with finality for all tax periods in which PSEG realized tax deductions from these transactions. On January 31, 2012, PSEG also signed a Form 870-AD settlement agreement covering all audit issues for tax years 1997 through 2003. On March 26, 2012, PSEG executed a Form 870-AD settlement agreement covering all audit issues for tax years 2004 through 2006. These two agreements conclude ten years of audits for PSEG and the leasing issue for all tax years. For PSEG, the impact of these agreements is an increase in financial statement Income Tax Expense of approximately $175 million. In prior periods, PSEG had established financial statement tax liabilities for uncertain tax positions in the amount of $246 million with respect to these tax years. Accordingly, the settlement resulted in a net $71 million decrease in the Income Tax Expense of PSEG.

Cash Impact

For tax years 1997 through 2003, the tax and interest PSEG owes the IRS as a result of this settlement will be reduced by the $320 million PSEG has on deposit with the IRS for this matter. PSEG paid a net deficiency for these years of approximately $4 million during the second quarter of 2012. Based upon the closing agreement and the Form 870-AD for tax years 2004 through 2006, PSEG owes the IRS approximately $620 million in tax and interest for tax years from 2004 through 2006. Based on the settlement of the leasing dispute, for tax years 2007 through 2010, the IRS owes PSEG approximately $676 million. PSEG has filed amended returns for tax years 2007-2010 reflecting the impact of the settlement. These returns have been audited by the IRS and accepted as filed. As required by statute, the IRS presented the refund claim to the Joint Committee on Taxation for approval. On October 16, 2012, PSEG was notified that the Joint Committee took no exception to the refund claim. The IRS is now processing those claims and preparing interest computations. In spite of the progress noted above, it is still possible that PSEG would have to pay $620 million over the next year to the IRS and wait while the IRS processes the $676 million refund claim in the normal course; it could take several years for the IRS to process these claims. In addition to the above, PSEG will claim a tax deduction for the accrued deficiency interest associated with this settlement in 2012, which will give rise to a cash tax savings of approximately $100 million.

Nuclear Insurance Coverages and Assessments

Power is a member of an industry mutual insurance company, Nuclear Electric Insurance Limited (NEIL), which provides the primary property and decontamination liability insurance at Salem, Hope Creek and Peach Bottom. NEIL also provides excess property insurance through its decontamination liability, decommissioning liability and excess property policy and replacement power coverage through its accidental outage policy. NEIL policies may make retrospective premium assessments in case of adverse loss experience. Power's maximum potential liabilities under these assessments are included in the table and notes below. Certain provisions in the NEIL policies provide that the insurer may suspend coverage with respect to all nuclear units on a site without notice if the NRC suspends or revokes the operating license for any unit on that site, issues a shutdown order with respect to such unit or issues a confirmatory order keeping such unit down.

The American Nuclear Insurers (ANI) and NEIL policies both include coverage for claims arising out of acts of terrorism. NEIL makes a distinction between certified and non-certified acts of terrorism, as defined under the Terrorism Risk Insurance Act (TRIA), and thus its policies respond accordingly. For non-certified acts of terrorism, NEIL policies are subject to an industry aggregate limit of $3.2 billion plus any amounts available through reinsurance or indemnity for non-certified acts of terrorism. For any act of terrorism, Power's nuclear liability policies will respond similarly to other covered events. For certified acts, Power's nuclear property NEIL policies will respond similarly to other covered events.

The Price-Anderson Act sets the "limit of liability" for claims that could arise from an incident involving any licensed nuclear facility in the United States The "limit of liability" is based on the number of licensed nuclear reactors and is adjusted at least every five years based on the Consumer Price Index. The current "limit of liability" is $12.6 billion. All owners of nuclear reactors, including Power, have provided for this exposure through a combination of private insurance and mandatory participation in a financial protection pool as established by the Price-Anderson Act. Under the Price-Anderson Act, each party with an ownership interest in a nuclear reactor can be assessed its share of $118 million per reactor per incident, payable at $18 million per reactor per incident per year. If the damages exceed the "limit of liability," the President is to submit to Congress a plan for providing additional compensation to the injured parties. Congress could impose further revenue-raising measures on the nuclear industry to pay claims. Power's maximum aggregate assessment per incident is $370 million (based on Power's ownership interests in Hope Creek, Peach Bottom and Salem) and its maximum aggregate annual assessment per incident is $55 million. Further, a decision by the U.S. Supreme Court, not involving Power, has held that the Price-Anderson Act did not preclude awards based on state law claims for punitive damages.

Power's insurance coverages and maximum retrospective assessments for its nuclear operations are as follows:

Type and Source of Coverages	Total Site Coverage		Retrospective Assessments
	Millions		
Public and Nuclear Worker Liability (Primary Layer):			
ANI	$ 375	(A)	$ —
Nuclear Liability (Excess Layer):			
Price-Anderson Act	12,219	(B)	370
Nuclear Liability Total	**$ 12,594**	(C)	**$ 370**
Property Damage (Primary Layer):			
NEIL Primary (Salem/Hope Creek/Peach Bottom)	$ 500		$ 22
Property Damage (Excess Layers):			
NEIL II (Salem/Hope Creek/Peach Bottom)	750		8
NEIL Blanket Excess (Salem/Hope Creek/Peach Bottom)	850	(D)	5
Property Damage Total (Per Site)	**$ 2,100**		**$ 35**
Accidental Outage:			
NEIL I (Peach Bottom)	$ 245	(E)	$ 6
NEIL I (Salem)	281	(E)	7
NEIL I (Hope Creek)	490	(E)	6
Replacement Power Total	**$ 1,016**		**$ 19**

(A) The primary limit for Public Liability is a per site aggregate limit with no potential for assessment. The Nuclear Worker Liability represents the potential liability from workers claiming exposure to the hazard of nuclear radiation. This coverage is subject to an industry aggregate limit that is subject to reinstatement at ANI discretion.

(B) Retrospective premium program under the Price-Anderson Act liability provisions of the Atomic Energy Act of 1954, as amended. Power is subject to retrospective assessment with respect to loss from an incident at any licensed nuclear reactor in the United States that produces greater than 100 MW of electrical power. This retrospective assessment can be adjusted for inflation every five years. The last adjustment was effective as of October 29, 2008. The next adjustment is due on or before October 29, 2013. This retrospective program is in excess of the Public and Nuclear Worker Liability primary layers.

(C) Limit of liability under the Price-Anderson Act for each nuclear incident.

(D) For property limits in excess of $1.25 billion, Power participates in a Blanket Limit policy where the $850 million limit is shared by Power with Exelon Generation among the Braidwood, Byron, Clinton, Dresden, La Salle, Limerick, Oyster Creek, Quad Cities, TMI-1 facilities owned by Exelon Generation and the Peach Bottom, Salem and Hope Creek facilities. This limit is not subject to reinstatement in the event of a loss. Participation in this program materially reduces Power's premium and the associated potential assessment.

(E) Peach Bottom has an aggregate indemnity limit based on a weekly indemnity of $2.3 million for 52 weeks followed by 80% of the weekly indemnity for 68 weeks. Salem has an aggregate indemnity limit based on a weekly indemnity of $2.5 million for 52 weeks followed by 80% of the weekly indemnity for 75 weeks. Hope Creek has an aggregate indemnity limit based on a weekly indemnity of $4.5 million for 52 weeks followed by 80% of the weekly indemnity for 71 weeks.

Minimum Lease Payments

Power, PSE&G and Energy Holdings have entered into various operating leases. The total future minimum payments of these operating leases as of December 31, 2012 are:

	PSEG	Power	PSE&G	Energy Holdings
	Millions			
2013	$ —	$ —	$ 7	$ 2
2014	—	1	6	2
2015	3	1	3	2
2016	12	1	3	2
2017	13	1	3	1
Thereafter	186	4	32	12
Total Minimum Lease Payments	**$ 214**	**$ 8**	**$ 54**	**$ 21**

Note 14. Schedule of Consolidated Debt

Long-Term Debt

	As of December 31, 2012	As of December 31, 2011
	Millions	
PSEG (Parent)		
Fair Value of Swaps (A)	$ 57	$ 62
Unamortized Discount Related to Debt Exchange (B)	(19)	(23)
Total Long-Term Debt of PSEG (Parent)	**$ 38**	**$ 39**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	Maturity	As of December 31, 2012	2011
		Millions	
Power			
Senior Notes:			
2.50%	2013	$ 300	$ 300
5.00%	2014	—	250
5.50%	2015	300	300
5.32%	2016	303	303
2.75%	2016	250	250
5.13%	2020	406	406
4.15%	2021	250	250
8.63%	2031	500	500
Total Senior Notes		2,309	2,559
Pollution Control Notes:			
Floating Rate (C)	2014	44	44
5.00%	2012	—	66
5.50%	2020	—	14
5.85%	2027	—	19
5.75%	2031	—	25
5.75%	2037	—	40
Total Pollution Control Notes		44	208
Principal Amount Outstanding		2,353	2,767
Amounts Due Within One Year		(300)	(66)
Net Unamortized Discount		(13)	(16)
Total Long-Term Debt of Power		**$ 2,040**	**$ 2,685**

Table of Contents

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	Maturity	As of December 31, 2012	2011
		Millions	
PSE&G			
First and Refunding Mortgage Bonds (D):			
6.75%	2016	$ 171	$ 171
9.25%	2021	134	134
8.00%	2037	7	7
5.00%	2037	8	8
Total First and Refunding Mortgage Bonds		320	320
Pollution Control Bonds (D):			
5.20%	2025	—	23
5.45%	2032	—	50
Floating rate (C)	2033	50	—
Floating rate (C)	2046	50	—
Total Pollution Control Bonds		100	73
Medium-Term Notes (MTNs) (D):			
5.13%	2012	—	300
5.00%	2013	150	150
5.38%	2013	300	300
6.33%	2013	275	275
0.85%	2014	250	250
5.00%	2014	250	250
2.70%	2015	300	300
5.30%	2018	400	400
7.04%	2020	9	9
3.50%	2020	250	250
5.25%	2035	250	250
5.70%	2036	250	250
5.80%	2037	350	350
5.38%	2039	250	250
5.50%	2040	300	300
3.95%	2042	450	—
3.65%	2042	350	—
Total MTNs		4,384	3,884
Principal Amount Outstanding		4,804	4,277
Amounts Due Within One Year		(725)	(300)
Net Unamortized Discount		(9)	(7)
Total Long-Term Debt of PSE&G (excluding Transition Funding and Transition Funding II)		**$ 4,070**	**$ 3,970**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	Maturity	As of December 31, 2012	2011
		Millions	
Transition Funding (PSE&G)			
Securitization Bonds:			
6.61%	2011-2013	$ 100	$ 305
6.75%	2013-2014	220	220
6.89%	2014-2015	370	370
Principal Amount Outstanding		690	895
Amounts Due Within One Year		(214)	(205)
Total Securitization Debt of Transition Funding		**476**	**690**
Transition Funding II (PSE&G)			
Securitization Bonds:			
4.34%	2011-2012	—	1
4.49%	2012-2013	9	20
4.57%	2013-2015	23	23
Principal Amount Outstanding		32	44
Amounts Due Within One Year		(12)	(11)
Total Securitization Debt of Transition Funding II		**20**	**33**
Total Long-Term Debt of PSE&G		**$ 4,566**	**$ 4,693**

Energy Holdings	Maturity	As of December 31, 2012	2011
		Millions	
Non-Recourse Project Debt (E):			
Resources - 5.00% to 8.75%	2011-2020	$ 44	$ 45
Resources - Other (F)	2012	—	50
Principal Amount Outstanding		44	95
Amounts Due Within One Year		(1)	(51)
Total Non-Recourse Project Debt		43	44
Total Long-Term Debt of Energy Holdings		**$ 43**	**$ 44**

(A) PSEG entered into various interest rate swaps to hedge the fair value of certain debt at Power. The fair value adjustments from these hedges are reflected as offsets to long-term debt on the Consolidated Balance Sheet. For additional information, see Note 16. Financial Risk Management Activities.

(B) In September 2009, Power completed an exchange offer with eligible holders of Energy Holdings' 8.50% Senior Notes due 2011 in order to manage long-term debt maturities. Since the debt exchange was between two subsidiaries of the same parent company, PSEG, and treated as a debt modification for accounting purposes, the resulting premium was deferred and is being amortized over the term of the newly issued debt. The deferred amount is reflected as an offset to Long-Term Debt on PSEG's Consolidated Balance Sheet.

(C) The Pennsylvania Economic Development Authority (PEDFA) bond and The Pollution Control Financing Authority of Salem County bonds for Power and PSE&G, respectively, are variable rate bonds that are in weekly reset mode.

(D) Secured by essentially all property of PSE&G pursuant to its First and Refunding Mortgage.

(E) Non-recourse financing transactions consist of loans from banks and other lenders that are typically secured by project assets and cash flows and generally impose no material obligation on the parent-level investor to repay any debt incurred by the project borrower. The consequences of permitting a project-level default include the potential for loss of any invested equity by the parent.

(F) As a result of the Dynegy bankruptcy proceedings, Energy Holdings ceased leveraged lease accounting and recorded the related nonrecourse project debt on its balance sheet at its fair value of $50 million. Upon settlement of the claims against Dynegy in 2012, Energy Holdings was released from this debt.

Long-Term Debt Maturities

The aggregate principal amounts of maturities for each of the five years following December 31, 2012 are as follows:

		PSE&G			Energy Holdings	
Year	Power	PSE&G	Transition Funding	Transition Funding II	Non-Recourse Debt	Total
			Millions			
2013	$ 300	$ 725	$ 214	$ 12	$ 1	$ 1,252
2014	44	500	225	12	1	782
2015	300	300	251	8	17	876
2016	553	171	—	—	7	731
2017	—	—	—	—	1	1
Thereafter	1,156	3,108	—	—	17	4,281
Total	**$ 2,353**	**$ 4,804**	**$ 690**	**$ 32**	**$ 44**	**$ 7,923**

Long-Term Debt Financing Transactions

During 2012, PSEG and its subsidiaries had the following Long-Term Debt issuances, maturities and redemptions:

Power

- redeemed $250 million of 5.00% Senior Notes due April 1, 2014,
- redeemed and retired Pollution Control Notes servicing and securing $98 million of tax-exempt financings, including $14 million of 5.50% York County Industrial Development Authority Pollution Control Revenue Refunding Bonds due September 1, 2020; $19 million of 5.85% Indiana County Industrial Development Authority Pollution Control Revenue Refunding Bonds due June 1, 2027; $25 million of 5.75% Pollution Control Financing Authority of Salem County Pollution Control Revenue Refunding Bonds due April 1, 2031; and $40 million of 5.75% Connecticut Development Authority Solid Waste Disposal Facility Revenue Bonds due November 1, 2037,
- paid $66 million of 5.00% Pollution Control Revenue Refunding Notes at maturity, and
- paid cash dividends of $600 million to PSEG.

PSE&G

- remarketed $50 million of weekly-reset variable rate demand bonds of the Pollution Control Financing Authority of Salem County due November 1, 2033, which are serviced and secured by PSE&G's First and Refunding Mortgage Bonds of like tenor,
- paid $300 million of 5.13% Secured Medium-Term Notes at maturity,
- issued $350 million of 3.65% Secured Medium-Term Notes, Series H due September 2042,
- refinanced at par $50 million of 5.45% fixed rate Pollution Control Financing Authority of Salem County Authority Bonds due February 1, 2032, which were serviced and secured by PSE&G’s First and Refunding Mortgage Bonds of like tenor, with $50 million of weekly-reset variable rate demand bonds due April 1, 2046, which are serviced and secured by PSE&G’s First and Refunding Mortgage Bonds of like tenor,
- redeemed and retired at par $23 million of 5.20% fixed rate Pollution Control Financing Authority of Salem County Authority Bonds due March 1, 2025, which were serviced and secured by PSE&G’s First and Refunding Mortgage Bonds of like tenor,
- issued $450 million of 3.95% Secured Medium-Term Notes, Series H due May 2042,
- paid $205 million of Transition Funding’s securitization debt, and

- paid $11 million of Transition Funding II's securitization debt.

Energy Holdings

- was released from $50 million of nonrecourse project debt related to the Dynegy Leases, and
- paid cash dividends of $500 million to PSEG.

PSE&G

In January 2013, PSE&G issued $400 million of 3.80% Secured Medium-Term Notes, Series H, due January 2043, and paid $150 million of 5.00% Secured Medium-Term Notes, at maturity.

Short-Term Liquidity

PSEG meets its short-term liquidity requirements primarily through the issuance of commercial paper. PSE&G maintains its own separate commercial paper program to meet its short-term liquidity requirements. Both commercial paper programs are fully back-stopped by their own separate credit facilities.

The commitments under our credit facilities are provided by a diverse bank group. As of December 31, 2012, no single institution represented more than 8% of the total commitments in our credit facilities.

As of December 31, 2012, our total credit capacity was in excess of our anticipated maximum liquidity requirements.

Each of our credit facilities is restricted as to availability and use to the specific companies as listed below; however, if necessary, the PSEG facilities can also be used to support our subsidiaries' liquidity needs. Our total credit facilities and available liquidity as of December 31, 2012 were as follows:

Company/Facility	As of December 31, 2012 Total Facility	Usage	Available Liquidity	Expiration Date	Primary Purpose
	Millions				
PSEG					
5-year Credit Facility	$ 500	$ 4 (A)	$ 496	Mar 2017	Commercial Paper (CP) Support/Funding/Letters of Credit
5-year Credit Facility	500	—	500	Apr 2016	CP Support/Funding/Letters of Credit
Total PSEG	**$ 1,000**	**$ 4**	**$ 996**		
Power					
5-year Credit Facility	$ 1,600	$ 65 (A)	$ 1,535	Mar 2017	Funding/Letters of Credit
5-year Credit Facility	1,000	—	1,000	Apr 2016	Funding/Letters of Credit
Bilateral Credit Facility	100	100 (A)	—	Sept 2015	Letters of Credit
Total Power	**$ 2,700**	**$ 165**	**$ 2,535**		
PSE&G					
5-year Credit Facility	$ 600	$ 276 (B)	$ 324	Apr 2016	CP Support/Funding/Letters of Credit
Total PSE&G	**$ 600**	**$ 276**	**$ 324**		
Total	**$ 4,300**	**$ 445**	**$ 3,855**		

(A) Includes amounts related to letters of credit outstanding.
(B) Includes amounts related to CP and letters of credit outstanding

Fair Value of Debt

The estimated fair values were determined using the market quotations or values of instruments with similar terms, credit ratings, remaining maturities and redemptions as of December 31, 2012 and 2011. See Note 17. Fair Value Measurements for more information on fair value guidance and the hierarchy that prioritizes the inputs to fair value measurements into three levels.

	December 31, 2012		December 31, 2011	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	Millions			
Long-Term Debt:				
PSEG (Parent) (A)	$ 38	$ 57	$ 39	$ 62
Power -Recourse Debt (B)	2,340	2,818	2,751	3,158
PSE&G (B)	4,795	5,606	4,270	4,905
Transition Funding (PSE&G) (B)	690	765	895	1,016
Transition Funding II (PSE&G) (B)	32	34	44	47
Energy Holdings:				
Project Level, Non-Recourse Debt (C)	44	44	95	95
	$ 7,939	**$ 9,324**	**$ 8,094**	**$ 9,283**

(A) Fair value represents net offsets to debt resulting from adjustments from interest rate swaps entered into to hedge certain debt at Power. Carrying amount represents such fair value reduced by the unamortized premium resulting from a debt exchange entered into between Power and Energy Holdings.

(B) The debt fair valuation is based on the present value of each bond's future cash flows. The discount rates used in the present value analysis are based on an estimate of new issue bond yields across the treasury curve. When a bond has embedded options, an interest rate model is used to reflect the impact of interest rate volatility into the analysis (primarily Level 2 measurements).

(C) Fair value amounts as of December 31, 2011 include $50 million of non-recourse project debt related to Dynegy which is classified as a Level 3 measurement. As of the June 5, 2012, the effective date of the amended settlement agreement, the $50 million of Notes Payable was written off. See the Fair Value Option Section of Note 17. Fair Value Measurements for additional information. Non-recourse project debt of $44 million is valued as equivalent to the amortized cost and is classified as a Level 3 measurement.

Note 15. Schedule of Consolidated Capital Stock

	As of December 31,			
	Outstanding Shares		Book Value	
	2012	2011	2012	2011
			Millions	
PSEG Common Stock (no par value) (A)				
Authorized 1,000,000,000 shares	505,892,472	505,945,286	$ 4,226	$ 4,222

(A) PSEG did not issue any new shares under the Dividend Reinvestment and Stock Purchase Plan (DRASPP) and the Employee Stock Purchase Plan (ESPP) in 2012 or 2011. Total authorized and unissued shares of common stock available for issuance through PSEG's DRASPP, ESPP and various employee benefit plans amounted to 7 million shares as of December 31, 2012.

As of December 31, 2012, there was an aggregate of 7.5 million shares of $100 par value and 10 million shares of $25 par value Cumulative Preferred Stock, which were authorized and unissued and which, upon issuance, may or may not provide for mandatory sinking fund redemption.

Note 16. Financial Risk Management Activities

The operations of PSEG, Power and PSE&G are exposed to market risks from changes in commodity prices, interest rates and equity prices that could affect their results of operations and financial condition. Exposure to these risks is managed through normal operating and financing activities and, when appropriate, through hedging transactions. Hedging transactions use derivative instruments to create a relationship in which changes to the value of the assets, liabilities or anticipated transactions exposed to market risks are expected to be offset by changes in the value of these derivative instruments.

Commodity Prices

The availability and price of energy commodities are subject to fluctuations due to weather, environmental policies, changes in supply and demand, state and federal regulatory policies, market conditions, transmission availability and other events. Power uses physical and financial transactions in the wholesale energy markets to mitigate the effects of adverse movements in fuel and electricity prices. Derivative contracts that do not qualify for hedge accounting or normal purchases/normal sales treatment are MTM with changes in fair value recorded in the income statement. The fair value for the majority of these contracts is obtained from quoted market sources. Modeling techniques using assumptions reflective of current market rates, yield curves and forward prices are used to interpolate certain prices when no quoted market exists.

Cash Flow Hedges

Power uses forward sale and purchase contracts, swaps and futures contracts to hedge

- forecasted energy sales from its generation stations and the related load obligations,
- the price of fuel to meet its fuel purchase requirements, and
- certain forecasted natural gas sales and purchases made to support the BGSS contract with PSE&G.

These derivative transactions are designated and effective as cash flow hedges. During the second quarter of 2012, Power de-designated certain of its commodity derivative transactions that had previously qualified as cash flow hedges as they were deemed to no longer be highly effective as required by the relevant accounting guidance. As a result, since June 1, 2012, Power recognizes all gains and losses from changes in the fair value of these derivatives immediately in earnings rather than deferring any such amounts in Accumulated Other Comprehensive Income (Loss). The fair values of Power's de-designated hedges were frozen in Accumulated Other Comprehensive Income (Loss) as the original forecasted transactions are still expected to occur and are reclassified into earnings as the original derivative transactions settle.

As of December 31, 2012 and 2011, the fair value and the impact on Accumulated Other Comprehensive Income (Loss) associated with accounting hedge activity was as follows:

	As of December 31,	
	2012	2011
	Millions	
Fair Value of Cash Flow Hedges	$ 3	$ 57
Impact on Accumulated Other Comprehensive Income (Loss) (after tax)	$ 9	$ 33

The expiration date of the longest-dated cash flow hedge at Power is in 2014. Power's after-tax unrealized gains on these derivatives that are expected to be reclassified to earnings during the next 12 months are $ 8 million. There was no ineffectiveness associated with qualifying hedges as of December 31, 2012.

Trading Derivatives

The primary purpose of Power's wholesale marketing operation is to optimize the value of the output of the generating facilities via various products and services available in the markets it serves. Historically, Power engaged in trading of electricity and energy-related products where such transactions were not associated with the output or fuel purchase requirements of its facilities. This trading consisted mostly of energy supply contracts where Power secured sales commitments with the intent to supply the energy services from purchases in the market rather than from its owned generation. Such trading activities were marked to market through the income statement and represented less than one percent of gross margin (revenues less energy costs) on an annual basis. Effective July 2011, Power has not entered into any trading derivative contracts and anticipates that it will not do so in the future.

Other Derivatives

Power enters into additional contracts that are derivatives, but do not qualify for or are not designated as cash flow hedges. These transactions are intended to mitigate exposure to fluctuations in commodity prices and optimize the value of its expected generation. Trade types include financial options, futures, swaps, fuel purchases and forward purchases and sales of electricity. Changes in fair market value of these contracts are recorded in earnings.

PSE&G is a party to certain long-term natural gas sales contracts to optimize its pipeline capacity utilization. In addition, as further described in Note 13. Commitments and Contingent Liabilities, PSE&G was directed to execute long-term SOCAs with certain generators to support the LCAPP Act. Two of the three generators cleared the Reliability Pricing Model auction for the 2015/2016 delivery year. These two SOCA contracts qualify as derivatives and are marked to fair value with the offset recorded to Regulatory Assets and Liabilities.

Interest Rates

PSEG, Power and PSE&G are subject to the risk of fluctuating interest rates in the normal course of business. Exposure to this risk is managed by targeting a balanced debt maturity profile which limits refinancing in any given period or interest rate environment. In addition, they have used a mix of fixed and floating rate debt, interest rate swaps and interest rate lock agreements.

Fair Value Hedges

PSEG enters into fair value hedges to convert fixed-rate debt into variable-rate debt. In order to redeem Power's $250 million of 5% Senior Notes due April 2014 in December 2012, PSEG terminated its $250 million interest rate swap that had converted this debt into variable-rate. As of December 31, 2012, PSEG had seven interest rate swaps outstanding totaling $850 million. These swaps convert Power’s $300 million of 5.5% Senior Notes due December 2015, $300 million of Power’s $303 million of 5.32% Senior Notes due September 2016 and Power’s $250 million of 2.75% Senior Notes due September 2016 into variable-rate debt. These interest rate swaps are designated and effective as fair value hedges. The fair value changes of the interest rate swaps are fully offset by the changes in the fair value of the underlying forecasted interest payments of the debt. As of December 31, 2012 and 2011, the fair value of all the underlying hedges was $57 million and $62 million, respectively.

Cash Flow Hedges

PSEG uses interest rate swaps and other derivatives, which are designated and effective as cash flow hedges, to manage its exposure to the variability of cash flows, primarily related to variable-rate debt instruments. The Accumulated Other Comprehensive Income (Loss) (after tax) related to interest rate derivatives designated as cash flow hedges was $(2) million as of December 31, 2012 and 2011.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Fair Values of Derivative Instruments

The following are the fair values of derivative instruments on the Consolidated Balance Sheets:

	As of December 31, 2012						
	Power				PSE&G	PSEG	Consolidated
	Cash Flow Hedges	Non Hedges			Non Hedges	Fair Value Hedges	
Balance Sheet Location	Energy-Related Contracts	Energy-Related Contracts	Netting (A)	Total Power	Energy-Related Contracts	Interest Rate Swaps	Total Derivatives
	Millions						
Derivative Contracts							
Current Assets	$ 3	$ 332	$ (217)	$ 118	$ 5	$ 15	$ 138
Noncurrent Assets	—	75	(26)	49	62	42	153
Total Mark-to-Market Derivative Assets	**$ 3**	**$ 407**	**$ (243)**	**$ 167**	**$ 67**	**$ 57**	**$ 291**
Derivative Contracts							
Current Liabilities	$ —	$ (265)	$ 219	$ (46)	$ —	$ —	$ (46)
Noncurrent Liabilities	—	(41)	26	(15)	(107)	—	(122)
Total Mark-to-Market Derivative (Liabilities)	**$ —**	**$ (306)**	**$ 245**	**$ (61)**	**$ (107)**	**$ —**	**$ (168)**
Total Net Mark-to-Market Derivative Assets (Liabilities)	**$ 3**	**$ 101**	**$ 2**	**$ 106**	**$ (40)**	**$ 57**	**$ 123**

	As of December 31, 2011						
	Power				PSE&G	PSEG	Consolidated
	Cash Flow Hedges	Non Hedges			Non Hedges	Fair Value Hedges	
Balance Sheet Location	Energy-Related Contracts	Energy-Related Contracts	Netting (A)	Total Power	Energy-Related Contracts	Interest Rate Swaps	Total Derivatives
	Millions						
Derivative Contracts							
Current Assets	$ 55	$ 532	$ (448)	$ 139	$ —	$ 17	$ 156
Noncurrent Assets	8	121	(74)	55	4	47	106
Total Mark-to-Market Derivative Assets	**$ 63**	**$ 653**	**$ (522)**	**$ 194**	**$ 4**	**$ 64**	**$ 262**
Derivative Contracts							
Current Liabilities	$ (5)	$ (506)	$ 387	$ (124)	$ (7)	$ —	$ (131)
Noncurrent Liabilities	(1)	(76)	53	(24)	—	(2)	(26)
Total Mark-to-Market Derivative (Liabilities)	**$ (6)**	**$ (582)**	**$ 440**	**$ (148)**	**$ (7)**	**$ (2)**	**$ (157)**
Total Net Mark-to-Market Derivative Assets (Liabilities)	**$ 57**	**$ 71**	**$ (82)**	**$ 46**	**$ (3)**	**$ 62**	**$ 105**

(A) Represents the netting of fair value balances with the same counterparty (where the right of offset exists) and the application of collateral. As of December 31, 2012 and December 31, 2011, net cash collateral paid of $2 million and net cash collateral received of $82 million, respectively, was netted against the corresponding net derivative contract positions. Of the $2 million as of December 31, 2012, cash collateral of $(3) million was netted against current assets and cash collateral of $5 million was netted against current liabilities. Of the $82 million as of December 31, 2011, cash collateral of $(77) million and $(23) million were netted against current assets and noncurrent assets, respectively, and cash collateral of $16 million and $2 million were netted against current liabilities and noncurrent liabilities, respectively.

Certain of Power's derivative instruments contain provisions that require Power to post collateral. This collateral may be posted in the form of cash or credit support with thresholds contingent upon Power's credit rating from each of the major credit rating agencies. The collateral and credit support requirements vary by contract and by counterparty. These credit risk-related contingent features stipulate that if Power were to be downgraded or lose its investment grade credit rating, it would be required to provide additional collateral. This incremental collateral requirement can offset collateral requirements related to other derivative instruments that are assets with the same counterparty, where the contractual right of offset exists under applicable master agreements. Power also enters into commodity transactions on the New York Mercantile Exchange (NYMEX) and Intercontinental Exchange (ICE). The NYMEX and ICE clearing houses act as counterparties to each trade. Transactions on the NYMEX and ICE must adhere to comprehensive collateral and margin requirements.

The aggregate fair value of all derivative instruments with credit risk-related contingent features in a liability position that are not fully collateralized (excluding transactions on the NYMEX and ICE that are fully collateralized) was $98 million and $285 million as of December 31, 2012 and 2011, respectively. As of December 31, 2012 and 2011, Power had the contractual right of offset of $61 million and $149 million, respectively, related to derivative instruments that are assets with the same counterparty under master agreements and net of margin posted. If Power had been downgraded or lost its investment grade rating, it would have had additional collateral obligations of $37 million and $136 million as of December 31, 2012 and 2011, respectively, related to its derivatives, net of the contractual right of offset under master agreements and the application of collateral. This potential additional collateral is included in the $654 million and $812 million as of December 31, 2012 and 2011, respectively, discussed in Note 13. Commitments and Contingent Liabilities.

The following shows the effect on the Consolidated Statements of Operations and on Accumulated Other Comprehensive Income (AOCI) of derivative instruments designated as cash flow hedges for the years ended December 31, 2012, 2011 and 2010:

Derivatives in Cash Flow Hedging Relationships	Amount of Pre-Tax Gain (Loss) Recognized in AOCI on Derivatives (Effective Portion) Years Ended December 31,			Location of Pre-Tax Gain (Loss) Reclassified from AOCI into Income	Amount of Pre-Tax Gain (Loss) Reclassified from AOCI into Income (Effective Portion) Years Ended December 31,			Amount of Pre-Tax Gain (Loss) Recognized in Income on Derivatives (Ineffective Portion) Years Ended December 31,		
	2012	2011	2010		2012	2011	2010	2012	2011	2010
					Millions					
PSEG (A)										
Energy-Related Contracts	$ 32	$ 84	$ 101	Operating Revenues	$ 79	$ 213	$ 222	$ 1	$ (2)	$ 1
Energy-Related Contracts	(4)	(4)	1	Energy Costs	(9)	2	(2)	—	—	—
Interest Rate Swaps	—	—	—	Interest Expense	—	(1)	(1)	—	—	—
Total PSEG	**$ 28**	**$ 80**	**$ 102**		**$ 70**	**$ 214**	**$ 219**	**$ 1**	**$ (2)**	**$ 1**
Power										
Energy-Related Contracts	$ 32	$ 84	$ 101	Operating Revenues	$ 79	$ 213	$ 222	$ 1	$ (2)	$ 1
Energy-Related Contracts	(4)	(4)	1	Energy Costs	(9)	2	(2)	—	—	—
Total Power	**$ 28**	**$ 80**	**$ 102**		**$ 70**	**$ 215**	**$ 220**	**$ 1**	**$ (2)**	**$ 1**

(A) Includes amounts for PSEG parent.

The following reconciles the AOCI for derivative activity included in the Accumulated Other Comprehensive Loss of PSEG on a pre-tax and after-tax basis:

AOCI	Pre-Tax	After-Tax
	Millions	
Balance as of December 31, 2010	**$ 188**	**$ 111**
Gain Recognized in AOCI	80	47
Less: Gain Reclassified into Income	(214)	(127)
Balance as of December 31, 2011	**$ 54**	**$ 31**
Gain Recognized in AOCI	28	17
Less: Gain Reclassified into Income	(70)	(41)
Balance as of December 31, 2012	**$ 12**	**$ 7**

The following shows the effect on the Consolidated Statements of Operations of derivative instruments not designated as hedging instruments or as normal purchases and sales for the years ended December 31, 2012, 2011 and 2010:

Derivatives Not Designated as Hedges	Location of Pre-Tax Gain (Loss) Recognized in Income on Derivatives	Pre-Tax Gain (Loss) Recognized in Income on Derivatives		
		Years Ended December 31,		
		2012	2011	2010
		Millions		
PSEG and Power				
Energy-Related Contracts	Operating Revenues	$ 232	$ 205	$ (53)
Energy-Related Contracts	Energy Costs	(19)	(42)	(9)
Total PSEG and Power		**$ 213**	**$ 163**	**$ (62)**

Power's derivative contracts reflected in the preceding tables include contracts to hedge the purchase and sale of electricity and natural gas and the purchase of fuel. Not all of these contracts qualify for hedge accounting. Most of these contracts are marked to market. The tables above do not include contracts for which Power has elected the normal purchase/normal sales exemption, such as its BGS contracts and certain other energy supply contracts that it has with other utilities and companies with retail load. In addition, PSEG has interest rate swaps designated as fair value hedges. The effect of these hedges was to reduce interest expense by $22 million, $25 million and $24 million for the years ended December 31, 2012, 2011 and 2010, respectively.

The following reflects the gross volume, on an absolute value basis, of derivatives as of December 31, 2012 and 2011:

Type	Notional	Total	PSEG	Power	PSE&G
			Millions		
As of December 31, 2012					
Natural Gas	Dth	596	—	404	192
Electricity	MWh	208	—	208	—
Capacity	MW days	4	—	—	4
FTRs	MWh	19	—	19	—
Interest Rate Swaps	U.S. Dollars	850	850	—	—
Coal	Tons	1	—	1	—
As of December 31, 2011					
Natural Gas	Dth	612	—	377	235
Electricity	MWh	137	—	137	—
FTRs	MWh	12	—	12	—
Interest Rate Swaps	U.S. Dollars	1,100	1,100	—	—
Coal	Tons	1	—	1	—

Credit Risk

Credit risk relates to the risk of loss that we would incur as a result of non-performance by counterparties pursuant to the terms of their contractual obligations. We have established credit policies that we believe significantly minimize credit risk. These policies include an evaluation of potential counterparties' financial condition (including credit rating), collateral requirements under certain circumstances and the use of standardized agreements, which allow for the netting of positive and negative exposures associated with a single counterparty. In the event of non-performance or non-payment by a major counterparty, there may be a material adverse impact on Power's and PSEG's financial condition, results of operations or net cash flows.

As of December 31, 2012, 94% of the credit for Power's operations was with investment grade counterparties. Credit exposure is defined as any positive results of netting accounts receivable/accounts payable and the forward value of open positions (which includes all financial instruments including derivatives and non-derivatives and normal purchases/normal sales).

The following table provides information on Power's credit risk from others, net of cash collateral, as of December 31, 2012. It further delineates that exposure by the credit rating of the counterparties and provides guidance on the concentration of credit risk to individual counterparties and an indication of the quality of Power's credit risk by credit rating of the counterparties.

Rating	Current Exposure	Securities held as Collateral	Net Exposure	Number of Counterparties >10%	Net Exposure of Counterparties >10%	
		Millions			Millions	
Investment Grade—External Rating	$ 317	$ 61	$ 313	2	$ 165	(A)
Non-Investment Grade—External Rating	22	—	22	—	—	
Investment Grade—No External Rating	10	—	10	—	—	
Non-Investment Grade—No External Rating	—	—	—	—	—	
Total	**$ 349**	**$ 61**	**$ 345**	**2**	**$ 165**	

(A) Includes net exposure of $119 million with PSE&G. The remaining net exposure of $46 million is with a nonaffiliated power purchaser which is a regulated investment grade counterparty.

The net exposure listed above, in some cases, will not be the difference between the current exposure and the collateral held. A counterparty may have posted more cash collateral than the outstanding exposure, in which case there would be no exposure.

When letters of credit have been posted as collateral, the exposure amount is not reduced, but the exposure amount is transferred to the rating of the issuing bank. As of December 31, 2012, Power had 174 active counterparties.

Note 17. Fair Value Measurements

PSEG, Power and PSE&G adopted accounting standard update "Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in GAAP and International Financial Reporting Standards (IFRS)" effective January 1, 2012. This standard defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements.

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. Accounting guidance for fair value measurement emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and establishes a fair value hierarchy that distinguishes between assumptions based on market data obtained from independent sources and those based on an entity's own assumptions. The hierarchy prioritizes the inputs to fair value measurement into three levels:

Level 1—measurements utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that PSEG, Power and PSE&G have the ability to access. These consist primarily of listed equity securities.

Level 2—measurements include quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, and other observable inputs such as interest rates and yield curves that are observable at commonly quoted intervals. These consist primarily of non-exchange traded derivatives such as forward contracts or options and most fixed income securities.

Level 3—measurements use unobservable inputs for assets or liabilities, based on the best information available and might include an entity's own data and assumptions. In some valuations, the inputs used may fall into different levels of the hierarchy. In these cases, the financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. As of December 31, 2012, these consisted primarily of electric swaps whose basis is deemed significant to the fair value measurement, electric load deals, long-term electric capacity contracts and long-term gas supply contracts.

The following tables present information about PSEG's, Power's and PSE&G's respective assets and (liabilities) measured at fair value on a recurring basis as of December 31, 2012 and December 31, 2011, including the fair value measurements and the levels of inputs used in determining those fair values. Amounts shown for PSEG include the amounts shown for Power and PSE&G.

	Recurring Fair Value Measurements as of December 31, 2012				
Description	Total	Cash Collateral Netting (E)	Quoted Market Prices for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	Millions				
PSEG					
Assets:					
Derivative Contracts:					
Energy-Related Contracts (A)	$ 234	$ (3)	$ —	$ 157	$ 80
Interest Rate Swaps (B)	$ 57	$ —	$ —	$ 57	$ —
NDT Fund (C)					
Equity Securities	$ 789	$ —	$ 789	$ —	$ —
Debt Securities—Govt Obligations	$ 285	$ —	$ —	$ 285	$ —
Debt Securities—Other	$ 342	$ —	$ —	$ 342	$ —
Other Securities	$ 124	$ —	$ —	$ 124	$ —
Rabbi Trust (C)					
Equity Securities—Mutual Funds	$ 18	$ —	$ 18	$ —	$ —
Debt Securities—Govt Obligations	$ 117	$ —	$ —	$ 117	$ —
Debt Securities—Other	$ 47	$ —	$ —	$ 47	$ —
Other Securities	$ 3	$ —	$ —	$ 3	$ —
Liabilities:					
Derivative Contracts:					
Energy-Related Contracts (A)	$ (168)	$ 5	$ —	$ (62)	$ (111)
Power					
Assets:					
Derivative Contracts:					
Energy-Related Contracts (A)	$ 167	$ (3)	$ —	$ 157	$ 13
NDT Fund (C)					
Equity Securities	$ 789	$ —	$ 789	$ —	$ —
Debt Securities—Govt Obligations	$ 285	$ —	$ —	$ 285	$ —
Debt Securities—Other	$ 342	$ —	$ —	$ 342	$ —
Other Securities	$ 124	$ —	$ —	$ 124	$ —
Rabbi Trust (C)					
Equity Securities—Mutual Funds	$ 3	$ —	$ 3	$ —	$ —
Debt Securities—Govt Obligations	$ 23	$ —	$ —	$ 23	$ —
Debt Securities—Other	$ 9	$ —	$ —	$ 9	$ —
Other Securities	$ 1	$ —	$ —	$ 1	$ —
Liabilities:					
Derivative Contracts:					
Energy-Related Contracts (A)	$ (61)	$ 5	$ —	$ (62)	$ (4)
PSE&G					
Assets:					
Derivative Contracts:					
Energy Related Contracts (A)	$ 67	$ —	$ —	$ —	$ 67
Rabbi Trust (C)					
Equity Securities—Mutual Funds	$ 6	$ —	$ 6	$ —	$ —
Debt Securities—Govt Obligations	$ 39	$ —	$ —	$ 39	$ —
Debt Securities—Other	$ 15	$ —	$ —	$ 15	$ —
Other Securities	$ 1	$ —	$ —	$ 1	$ —
Liabilities:					
Derivative Contracts:					
Energy Related Contracts (A)	$ (107)	$ —	$ —	$ —	$ (107)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Description	Total	Cash Collateral Netting (E)	Quoted Market Prices for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	Recurring Fair Value Measurements as of December 31, 2011				
			Millions		
PSEG					
Assets:					
Derivative Contracts:					
Energy-Related Contracts (A)	$ 198	$ (100)	$ —	$ 257	$ 41
Interest Rate Swaps (B)	$ 64	$ —	$ —	$ 64	$ —
NDT Fund (C)					
Equity Securities	$ 685	$ —	$ 685	$ —	$ —
Debt Securities—Govt Obligations	$ 359	$ —	$ —	$ 359	$ —
Debt Securities—Other	$ 281	$ —	$ —	$ 281	$ —
Other Securities	$ 24	$ —	$ —	$ 24	$ —
Rabbi Trust—Mutual Funds (C)	$ 172	$ —	$ 19	$ 153	$ —
Liabilities:					
Derivative Contracts:					
Energy-Related Contracts (A)	$ (155)	$ 18	$ —	$ (153)	$ (20)
Interest Rate Swaps (B)	$ (2)	$ —	$ —	$ (2)	$ —
Non-Recourse Debt (D)	$ (50)	$ —	$ —	$ —	$ (50)
Power					
Assets:					
Derivative Contracts:					
Energy-Related Contracts (A)	$ 194	$ (100)	$ —	$ 257	$ 37
NDT Fund (C)					
Equity Securities	$ 685	$ —	$ 685	$ —	$ —
Debt Securities—Govt Obligations	$ 359	$ —	$ —	$ 359	$ —
Debt Securities—Other	$ 281	$ —	$ —	$ 281	$ —
Other Securities	$ 24	$ —	$ —	$ 24	$ —
Rabbi Trust—Mutual Funds (C)	$ 33	$ —	$ 4	$ 29	$ —
Liabilities:					
Derivative Contracts:					
Energy-Related Contracts (A)	$ (148)	$ 18	$ —	$ (153)	$ (13)
PSE&G					
Assets:					
Derivative Contracts:					
Energy Related Contracts (A)	$ 4	$ —	$ —	$ —	$ 4
Rabbi Trust—Mutual Funds (C)	$ 57	$ —	$ 6	$ 51	$ —
Liabilities:					
Derivative Contracts:					
Energy Related Contracts (A)	$ (7)	$ —	$ —	$ —	$ (7)

(A) Level 2—Fair values for energy-related contracts are obtained primarily using a market-based approach. Most derivative contracts (forward purchase or sale contracts and swaps) are valued using the average of the bid/ask midpoints from multiple broker or dealer quotes or auction prices. Prices used in the valuation process are also corroborated independently by management to determine that values are based on actual transaction data or, in the absence of transactions, bid and offers for the day. Examples may include certain exchange and non-exchange traded capacity and electricity contracts and natural gas physical or swap contracts based on market prices, basis adjustments and other premiums where adjustments and premiums are not considered significant to the overall inputs.

Level 3—For energy-related contracts, which include more complex agreements where limited observable inputs or pricing information are available, modeling techniques are employed using assumptions reflective of contractual terms, current market rates, forward price curves, discount rates and risk factors, as applicable. Fair values of other energy contracts may be based on broker quotes that we cannot corroborate with actual market transaction data.

(B) Interest rate swaps are valued using quoted prices on commonly quoted intervals, which are interpolated for periods different than the quoted intervals, as inputs to a market valuation model. Market inputs can generally be verified and model selection does not involve significant management judgment.

(C) The NDT Fund maintains investments in various equity and fixed income securities classified as “available for sale.” The Rabbi Trust maintains investments in an S&P 500 index fund and various fixed income securities classified as “available for sale.” These securities are generally valued with prices that are either exchange provided (equity securities) or market transactions for comparable securities and/or broker quotes (fixed income securities).

Level 1—Investments in marketable equity securities within the NDT Fund are primarily investments in common stocks across a broad range of industries and sectors. Most equity securities are priced utilizing the principal market close price or, in some cases, midpoint, bid or ask price (primarily Level 1). The Rabbi Trust equity index fund is valued based on quoted prices in an active market (Level 1).

Level 2—NDT and Rabbi Trust fixed income securities are limited to investment grade corporate bonds and United States Treasury obligations or Federal Agency mortgage-backed securities with a wide range of maturities. Since many fixed income securities do not trade on a daily basis, they are priced using an evaluated pricing methodology that varies by asset class and reflects observable market information such as the most recent exchange price or quoted bid for similar securities. Market-based standard inputs typically include benchmark yields, reported trades, broker/dealer quotes, and issuer spreads (primarily Level 2). Short-term investments and certain commingled temporary investments are valued using observable market prices or market parameters such as time-to-maturity, coupon rate, quality rating and current yield (primarily Level 2).

(D) For Non-Recourse Debt, see Fair Value Option discussion.

(E) Cash collateral netting represents collateral amounts netted against derivative assets and liabilities as permitted under the accounting guidance for Offsetting of Amounts Related to Certain Contracts.

Additional Information Regarding Level 3 Measurements

For valuations that include both observable and unobservable inputs, if the unobservable input is determined to be significant to the overall inputs, the entire valuation is categorized in Level 3. This includes derivatives valued using indicative price quotations for contracts with tenors that extend into periods with no observable pricing. In instances where observable data is unavailable, consideration is given to the assumptions that market participants would use in valuing the asset or liability. This includes assumptions about market risks such as liquidity, volatility and contract duration. Such instruments are categorized in Level 3 because the model inputs generally are not observable. PSEG’s Risk Management Committee approves risk management policies and objectives for risk assessment, control and valuation, counterparty credit approval, and the monitoring and reporting of risk exposures. The Risk Management Committee reports to the Audit Committee of the PSEG Board of Directors on the scope of the risk management activities and is responsible for approving all valuation procedures at PSEG. Forward price curves for the power market utilized by Power to manage the portfolio are maintained and reviewed by PSEG’s Enterprise Risk Management market pricing group and used for financial reporting purposes. PSEG considers credit and nonperformance risk in the valuation of derivative contracts categorized in Levels 2 and 3, including both historical and current market data, in its assessment of credit and nonperformance risk by counterparty. The impacts of credit and nonperformance risk were not material to the financial statements.

The following table provides detail surrounding significant Level 3 valuations, of which the most significant positions are electric swaps and electric load deals for Power and long-term electric capacity contracts and long-term natural gas supply contracts for PSE&G. For Power, in general, electric swaps are valued based on at least two pricing inputs, basis and underlying. To the extent the basis component is based on a single broker quote and is significant to the fair value of the electric swap, it is categorized as Level 3. The remaining balance of Power’s Level 3 positions consist primarily of certain long-term electric capacity contracts, electric load deals in which load consumption may change hourly and certain long-term natural gas supply contracts. Long-term electric capacity contracts are measured at fair value using capacity auction prices. If the fair value for the unobservable tenor is significant, then the entire capacity contract is categorized as Level 3. Electric load deals are fair valued using certain unobservable inputs, such as historic load variability. For Power and PSE&G, long-term gas supply contracts are measured at fair value using both actively traded pricing points as well as unobservable inputs such as gas prices beyond observable periods and long-term basis quotes and accordingly, the fair value measurements are classified in Level 3. For PSE&G, long-term electric capacity contracts are measured at fair value using both observable capacity prices and unobservable inputs consisting of forecasts of future long-term electric capacity prices and include adjustments for contingencies, such as litigation risk and plant construction risk. Accordingly, the fair value measurements are classified as Level 3.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The table below discloses the significant unobservable inputs used in developing the fair value of these Level 3 positions:

Quantitative Information About Level 3 Fair Value Measurements

Commodity	Level 3 Position	Fair Value as of December 31, 2012 Assets	Fair Value as of December 31, 2012 (Liabilities)	Valuation Technique(s)	Significant Unobservable Input	Range
		Millions				
Power						
Electricity	Electric Swaps	$ 7	$ (1)	Discounted cash flow	Power Basis	$0 - $10/MWh
Electricity	Electric Load Deals	1	(2)	Discounted cash flow	Historic Load Variability	-5% - +10%
Other	Various (A)	5	(1)			
Total Power		**$ 13**	**$ (4)**			
PSE&G						
Gas and Capacity	Forward Contracts (B)	$ 67	$ (107)	Discounted cash flow	Long-Term Gas Basis and Capacity Prices	(B)
Total PSE&G		**$ 67**	**$ (107)**			
Total PSEG		**$ 80**	**$ (111)**			

(A) Includes long-term electric capacity and long-term gas supply positions which are immaterial.

(B) Includes long-term gas supply and long-term electric capacity positions with various unobservable inputs. Significant unobservable inputs for the gas supply contracts include long-term basis prices in the range of $0 to $2/MMBTU of natural gas. Unobservable inputs for the long-term electric capacity contracts include forecasted capacity prices in the range of $100 to $400/MW day.

Significant unobservable inputs listed above would have a direct impact on the fair values of the above Level 3 instruments if they were adjusted. For energy-related contracts in cases where Power and PSE&G are sellers, an increase in either the power basis or the load variability or the longer-term basis amounts would decrease the fair value. For long-term electric capacity contracts where Power or PSE&G are buyers, an increase in the capacity price would increase the fair value.

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

A reconciliation of the beginning and ending balances of Level 3 derivative contracts and securities for the years ended December 31, 2012 and 2011 follows:

Changes in Level 3 Assets and (Liabilities) Measured at Fair Value on a Recurring Basis
for the Year Ended December 31, 2012

Description	Balance as of January 1, 2012	Total Gains or (Losses) Realized/Unrealized: Included in Income (A)	Total Gains or (Losses) Realized/Unrealized: Included in Regulatory Assets/ Liabilities (B)	Purchases, (Sales) (C)	Issuances (Settlements) (D)	Transfers In (Out) (E)	Balance as of December 31, 2012
	Millions						
PSEG							
Net Derivative Assets (Liabilities)	$ 21	$ 42	$ (37)	$ —	$ (57)	$ —	$ (31)
Non-Recourse Debt	$ (50)	$ 50	$ —	$ —	$ —	$ —	$ —
Power							
Net Derivative Assets (Liabilities)	$ 24	$ 42	$ —	$ —	$ (57)	$ —	$ 9
PSE&G							
Net Derivative Assets (Liabilities)	$ (3)	$ —	$ (37)	$ —	$ —	$ —	$ (40)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Changes in Level 3 Assets and (Liabilities) Measured at Fair Value on a Recurring Basis for the Year Ended December 31, 2011

		Total Gains or (Losses) Realized/Unrealized					
Description	**Balance as of January 1, 2011**	**Included in Income (A)**	**Included in Regulatory Assets/ Liabilities (B)**	**Purchases, (Sales) (C)**	**Issuances (Settlements) (D)**	**Transfers In (Out) (E)**	**Balance as of December 31, 2011**
				Millions			
PSEG							
Net Derivative Assets (Liabilities)	$ 47	$ 22	$ (8)	$ 30	$ (37)	$ (33)	$ 21
NDT Fund	$ 8	$ —	$ —	$ —	$ —	$ (8)	$ —
Non-Recourse Debt	$ —	$ —	$ —	$ —	$ (50)	$ —	$ (50)
Power							
Net Derivative Assets (Liabilities)	$ 42	$ 22	$ —	$ 30	$ (37)	$ (33)	$ 24
NDT Fund	$ 8	$ —	$ —	$ —	$ —	$ (8)	—
PSE&G							
Net Derivative Assets (Liabilities)	$ 5	$ —	$ (8)	$ —	$ —	$ —	$ (3)

(A) PSEG's and Power's gains and losses attributable to changes in net derivative assets and liabilities include $42 million and $17 million in Operating Income in 2012 and 2011, $0 million and $2 million in OCI in 2012 and 2011, and $3 million in Income from Discontinued Operations in 2011. Of the $42 million in Operating Income in 2012, $(15) million is unrealized. Of the $17 million in Operating Income in 2011, $9 million is unrealized. Energy Holding's release from its obligations under the non-recourse debt is included in PSEG's Operating Income and is offset by the write-off of the related assets.

(B) Mainly includes gains/losses on PSE&G's derivative contracts that are not included in either earnings or OCI, as they are deferred as a Regulatory Asset/Liability and are expected to be recovered from/returned to PSE&G's customers.

(C) Includes $66 million in purchases and $(36) million in sales in 2011.

(D) Represents $(57) million in settlements for derivative contracts in 2012. Includes $(25) million in issuances and $(12) million in settlements for derivative contracts and includes $(50) million of issuances due to initial recognition of lessor notes resulting from rejection of the Dynegy leveraged leases in 2011. See Fair Value Option discussion.

(E) During the year ended December 31, 2012, there were no transfers among levels. During the year ended December 31, 2011, $ 8 million of assets in the NDT Fund were transferred from Level 3 to Level 2, due to more observable pricing for the underlying securities and $33 million of net derivative assets were transferred from Level 3 to Level 2 due to more available observable market data. The transfers were recognized as of the beginning of the first quarter and fourth quarter, respectively, (i.e. the quarters in which the transfers occurred), as per PSEG's policy.

As of December 31, 2012, PSEG carried $1.8 billion of net assets that are measured at fair value on a recurring basis, of which $ 31 million of net liabilities were measured using unobservable inputs and classified as Level 3 within the fair value hierarchy.

As of December 31, 2011, PSEG carried $1.6 billion of net assets that are measured at fair value on a recurring basis, of which $ 29 million of net liabilities were measured using unobservable inputs and classified as Level 3 within the fair value hierarchy.

Fair Value Option

As of December 31, 2011, the effective date of the Dynegy lease rejections, the leases of the Roseton and Danskammer generation facilities were effectively terminated and no longer qualified for leveraged lease accounting under the guidance for leases. As the owner of the facilities, Energy Holdings was required to recognize the underlying assets and nonrecourse notes payable (Notes Payable) associated with these leases at their respective fair values on the effective date of the rejection. Energy Holdings elected to record the Notes Payable at fair value each reporting period under the fair value option in accordance with guidance for Financial Instruments. The fair value option permits the irrevocable fair value election for selected eligible financial assets or liabilities. Any changes in the fair value of the Notes Payable are included in earnings each period. The $ 550 million of contractual principal outstanding on the Notes Payable was valued at $50 million as of December 31, 2011. Energy Holdings elected this option to eliminate certain complexities in applying the effective interest method of amortization given the uncertain payment streams between the election date and the expected foreclosure date. There were no other debt instruments of this type eligible for the fair value option as of December 31, 2011. The $ 50 million fair value of these Notes Payable is included on PSEG's Consolidated Balance Sheet as of December 31, 2011. The fair values of the Notes Payable include significant internal assumptions based on expected cash flows and the fair values of the underlying collateral. Changes to projected capacity factors, capacity and energy prices, fuel costs and other required cash outflows could significantly impact the fair value of the collateral which would increase or decrease the fair value of the Notes. These Notes Payable are classified as Level 3 in the fair value hierarchy as a result of mainly unobservable inputs. As of the June 5, 2012 effective date of the amended settlement agreement, the Notes Payable and related assets were written off.

The table of fair value of debt is included in Note 14. Schedule of Consolidated Debt.

Non-recurring Fair Value Measurements

2011

During the fourth quarter of 2011, DH filed for protection under Chapter 11 of the U.S. Bankruptcy Code. As a result of the settlement agreement that was reached relating to the lease of electric generation facilities to subsidiaries of DH (See Note 8. Financing Receivables), Energy Holdings ceased leveraged lease accounting for the leased assets and recorded those generation facilities at their respective fair values totaling $50 million, which were carried as nonrecurring fair values as of December 31, 2011. The fair values of those generation facilities were determined based on a third party appraisal using significant assumptions including expectations of cash flows which are considered mainly unobservable inputs (Level 3).

Note 18. Stock Based Compensation

PSEG's 2004 Long-Term Incentive Plan (2004 LTIP) is a broad-based equity compensation program that provides for grants of various long-term incentive compensation awards, such as stock options, stock appreciation rights, performance units, restricted stock, restricted stock units, cash awards or any combination thereof. The types of long-term incentive awards that have been granted and remain outstanding under the 2004 LTIP are non-qualified options to purchase shares of PSEG's common stock, restricted stock awards, restricted stock unit awards and performance unit awards. The type of equity award that is granted and the details of that award may vary from time to time and is subject to the approval of the Organization and Compensation Committee of PSEG's Board of Directors (OCC), the plan's administrative committee.

The 2004 LTIP currently provides for the issuance of equity awards with respect to approximately 26 million shares of common stock. As of December 31, 2012, there were approximately 17 million shares available for future awards under the 2004 LTIP.

Stock Options

Under the 2004 LTIP, non-qualified options to acquire shares of PSEG common stock may be granted to officers and other key employees selected by the OCC. Option awards are granted with an exercise price equal to the market price of PSEG's common stock at the grant date. The options generally vest over four years of continuous service. Vesting schedules may be accelerated upon the occurrence of certain events, such as a change-in-control (unless substituted with an equity award of equal value), retirement, death or disability. Options are exercisable over a period of time designated by the OCC (but not prior to one year or longer than 10 years from the date of grant) and are subject to such other terms and conditions as the OCC determines. Payment by option holders upon exercise of an option may be made in cash or, with the consent of the OCC, by delivering previously acquired shares of PSEG common stock.

Restricted Stock

Under the 2004 LTIP, PSEG has granted restricted stock awards to officers and other key employees. These shares are subject to risk of forfeiture until vested by continued employment. Restricted stock generally vests annually over three or four years, but is considered outstanding at the time of grant, as the recipients are entitled to dividends and voting rights. Vesting may be accelerated upon certain events, such as change-in-control (unless substituted with an equity award of equal value), retirement, death or disability.

Restricted Stock Units

Under the 2004 LTIP, PSEG has granted restricted stock unit awards to officers and other key employees. These awards, which are bookkeeping entries only, are subject to risk of forfeiture until vested by continued employment. Until vested, the units are credited with dividend equivalents proportionate to the dividends paid on PSEG common stock. Distributions are made in shares of common stock. The restricted stock unit grants for 2012 and 2011 generally vest at the end of three years. Vesting may be accelerated upon certain events such as change-in-control or death. Prior to 2011, restricted stock unit grants generally vested over four years.

Performance Units

Under the 2004 LTIP, performance units were granted to officers and other key employees, which provide for payment in shares of PSEG common stock based on achievement of certain financial goals over a three-year performance period. The payout varies from 0% to 200% of the number of performance units granted depending on PSEG's performance with respect to certain financial targets, including targets related to comparative performance against other companies in a peer group of energy companies. The performance units are credited with dividend equivalents in an amount equal to dividends paid on PSEG common stock up until the shares are distributed. Vesting may be pro-rated for the employee's service during the performance period as a result of certain events, such as change-in-control (unless substituted with an equity award of equal value), retirement, death or disability.

Stock-Based Compensation

All outstanding unvested stock options are being expensed based on their grant date fair values, which were determined using the Black-Scholes option-pricing model. Stock option awards are expensed on a tranche-specific basis over the requisite service period of the award. Ultimately, compensation expense for stock options is recognized for awards that vest.

PSEG recognizes compensation expense for restricted stock and restricted stock units over the vesting period based on the grant date fair market value of the shares, which is equal to the market price of PSEG's common stock on the date of the grant.
PSEG recognizes compensation expense for performance units based on the grant date fair values of the award, which were determined using the Monte Carlo model. The accrual of compensation cost was based on the probable achievement of the performance conditions, which result in a payout from 0% to 200% of the initial grant. The accrual during the year of grant is estimated at 100% of the original grant. The accrual may be adjusted for subsequent changes in the estimated or actual outcome.

	2012	2011	2010
		Millions	
Compensation Cost included in Operation and Maintenance Expense	$ 25	$ 23	$ 29
Income Tax Benefit Recognized in Consolidated Statement of Operations	$ 10	$ 10	$ 12

There was less than $1 million of excess tax benefits for 2012. The was $1 million of excess tax benefits included as financing cash flows on the Consolidated Statements of Cash Flow for each of the years ended December 31, 2011 and 2010, respectively.

PSEG recognizes compensation cost of awards issued over the shorter of the original vesting period or the period beginning on the date of grant and ending on the date an individual is eligible for retirement and the award vests.

Stock Options

Changes in stock options for 2012 are summarized as follows:

	Options	Weighted Average Exercise Price	Weighted Average Remaining Years Contractual Term	Aggregate Intrinsic Value
Outstanding as of January 1, 2012	3,272,300	$ 32.78		
Exercised	326,900	$ 20.10		
Outstanding as of December 31, 2012	**2,945,400**	**$ 34.19**	**5.3**	**$ 1,509,670**
Exercisable at December 31, 2012	2,750,325	$ 34.24	5.2	$ 1,506,268

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model. There were no option grants in 2012, 2011 and 2010.

Activity for options exercised for the years ended December 31, 2012, 2011 and 2010 is shown below:

	2012	2011	2010
		Millions	
Total Intrinsic Value of Options Exercised	$ 4	$ 2	$ 1
Cash Received from Options Exercised	$ 7	$ 6	$ 3
Tax Benefit Realized from Options Exercised	$ 1	$ 1	$ 1

Less than one million options vested during each of the years ended December 31, 2012, 2011 and 2010. The total fair value of the stock options vested during the years ended December 31, 2012, 2011 and 2010 was $3 million, $5 million and $7 million, respectively.

As of December 31, 2012, there was approximately $1 million of unrecognized compensation cost related to stock options, which is to be recognized over a weighted average period of 0.5 years.

Restricted Stock

Changes in restricted stock for the year ended December 31, 2012 are summarized as follows:

	Shares	Weighted Average Grant Date Fair Value	Weighted Average Remaining Years Contractual Term	Aggregate Intrinsic Value
Non-vested as of January 1, 2012	70,300	$ 32.83		
Vested	1,500	$ 44.44		
Non-vested as of December 31, 2012	**68,800**	**$ 32.57**	**0.2**	**$ 2,105,280**

There were no restricted stock awards granted in 2012, 2011 and 2010.

The total intrinsic value of restricted stock vested during the years ended December 31, 2012, 2011 and 2010 was less than $1 million, $1 million and $3 million, respectively.

Restricted Stock Units

Changes in restricted stock units for the year ended December 31, 2012 are summarized as follows:

	Shares		Weighted Average Grant Date Fair Value	Weighted Average Remaining Years Contractual Term		Aggregate Intrinsic Value
Non-vested as of January 1, 2012	648,551	$	31.17			
Granted	345,440	$	30.95			
Vested	125,838	$	30.87			
Canceled/Forfeited	33,626	$	31.24			
Non-vested as of December 31, 2012	**834,527**	**$**	**31.12**	**1.2**	**$**	**25,536,532**

The weighted average grant date fair value per share for restricted stock during the years ended December 31, 2012, 2011 and 2010 was $30.95, $32.03 and $31.13 per share, respectively.

The total intrinsic value of restricted stock units vested during the years ended December 31, 2012, 2011 and 2010 was $5 million, $7 million and $6 million, respectively.

As of December 31, 2012, there was approximately $9 million of unrecognized compensation cost related to the restricted stock units, which is expected to be recognized over a weighted average period of 1.0 year. Dividend equivalents units of 40,044 accrued on the restricted stock units during the year.

Performance Share Units

Changes in Performance Share Units for the year ended December 31, 2012 are summarized as follows:

	Shares		Weighted Average Grant Date Fair Value	Weighted Average Remaining Years Contractual Term		Aggregate Intrinsic Value
Non-vested as of January 1, 2012	641,986	$	35.13			
Granted	404,460	$	31.25			
Vested	258,501	$	36.35			
Canceled/Forfeited	37,952	$	33.51			
Non-vested as of December 31, 2012	**749,993**	**$**	**32.70**	**1.5**	**$**	**22,949,786**

The weighted average grant date fair value per share for performance share units during the years ended December 31, 2012, 2011 and 2010 was $31.25, $35.33 and $34.29 per share, respectively.

The total intrinsic value of performance share units vested during the year ended December 31, 2012, 2011 and 2010 was $4 million, $9 million and $15 million, respectively.

As of December 31, 2012, there was approximately $13 million of unrecognized compensation cost related to the performance share units, which is expected to be recognized over a weighted average period of 1.0 year. Dividend equivalents units of 49,170 accrued on the performance share units during the year.

Outside Directors

Under the Directors Equity Plan, annually, on the first business day of May, each non-employee member of the Board of Directors is awarded stock units based on amount of annual compensation to be paid at the closing price of PSEG common stock on that date. Dividend equivalents are credited quarterly and distributions will commence upon the director leaving the Board.

The fair value of these awards is recorded as compensation expense in the Consolidated Statements of Operations. Compensation expense for the plan for each of the years ended December 31, 2012, 2011 and 2010 was approximately $1 million.

Employee Stock Purchase Plan (ESPP)

PSEG maintains an ESPP for all eligible employees of PSEG and its subsidiaries. Under the ESPP, shares of PSEG common stock may be purchased at 95% of the fair market value through payroll deductions. In any year, employees may purchase shares having a value not exceeding 10% of their base pay. During the years ended December 31, 2012, 2011 and 2010, employees purchased 191,572, 183,338 and 178,684 shares at an average price of $31.32, $30.69 and $30.32 per share, respectively. As of December 31, 2012, 3.6 million shares were available for future issuance under this plan.

Note 19. Other Income and Deductions

Other Income	Power	PSE&G	Other (A)	Consolidated Total
	Millions			
Year Ended December 31, 2012				
NDT Fund Gains, Interest, Dividend and Other Income	$ 194	$ —	$ —	$ 194
Allowance of Funds Used During Construction	—	23	—	23
Rabbi Trust Realized Gains, Interest and Dividends	2	4	5	11
Solar Loan Interest	—	18	—	18
Other	3	7	4	14
Total Other Income	**$ 199**	**$ 52**	**$ 9**	**$ 260**
Year Ended December 31, 2011				
NDT Fund Gains, Interest, Dividend and Other Income	$ 186	$ —	$ —	$ 186
Allowance of Funds Used During Construction	—	9	—	9
Solar Loan Interest	—	10	—	10
Other	4	6	5	15
Total Other Income	**$ 190**	**$ 25**	**$ 5**	**$ 220**
Year Ended December 31, 2010				
NDT Fund Gains, Interest, Dividend and Other Income	$ 159	$ —	$ —	$ 159
Allowance of Funds Used During Construction	—	5	—	5
Rabbi Trust Realized Gains	7	11	13	31
Solar Loan Interest	—	6	—	6
Other	4	4	12	20
Total Other Income	**$ 170**	**$ 26**	**$ 25**	**$ 221**

Other Deductions	Power	PSE&G	Other (A)	Consolidated Total
	Millions			
Year Ended December 31, 2012				
NDT Fund Realized Losses and Expense	$ 58	$ —	$ —	$ 58
Loss on Early Extinguishment of Debt	15	—	—	15
Other	17	5	3	25
Total Other Deductions	**$ 90**	**$ 5**	**$ 3**	**$ 98**
Year Ended December 31, 2011				
NDT Fund Realized Losses and Expense	$ 50	$ —	$ —	$ 50
Loss on Early Extinguishment of Debt	17	—	—	17
Other	12	4	2	18
Total Other Deductions	**$ 79**	**$ 4**	**$ 2**	**$ 85**
Year Ended December 31, 2010				
NDT Fund Realized Losses and Expense	$ 45	$ —	$ —	$ 45
Other	8	3	7	18
Total Other Deductions	**$ 53**	**$ 3**	**$ 7**	**$ 63**

(A) Other primarily consists of activity at PSEG (parent company), Energy Holdings and Services and intercompany eliminations.

Note 20. Income Taxes

A reconciliation of reported income tax expense for PSEG with the amount computed by multiplying pre-tax income by the statutory federal income tax rate of 35% is as follows:

	Years Ended December 31,		
	2012	2011	2010
		Millions	
Net Income	$ 1,275	$ 1,503	$ 1,564
Income (Loss) from Discontinued Operations, including Gain on Disposal, net of tax benefit	—	96	7
Income from Continuing Operations	1,275	1,407	1,557
Preferred Dividends	—	—	(1)
Income from Continuing Operations, excluding Preferred Dividends	$ 1,275	$ 1,407	$ 1,558
Income Taxes:			
Operating Income:			
Current Expense:			
Federal	$ (204)	$ 258	$ (166)
State	(2)	32	157
Total Current	(206)	290	(9)
Deferred Expense:			
Federal	758	501	992
State	125	191	79
Total Deferred	883	692	1,071
Investment Tax Credit	59	(5)	(3)
Total Income Taxes	**$ 736**	**$ 977**	**$ 1,059**
Pre-Tax Income	$ 2,011	$ 2,384	$ 2,617
Tax Computed at Statutory Rate @ 35%	$ 704	$ 834	$ 916
Increase (Decrease) Attributable to Flow-Through of Certain Tax Adjustments:			
State Income Taxes (net of federal income tax)	115	146	154
Uncertain Tax Positions	4	19	30
Manufacturing Deduction	—	(15)	(24)
Nuclear Decommissioning Trust	10	14	10
Plant-Related Items	(5)	(6)	(3)
Tax Credits	(10)	(5)	(2)
Audit Settlement	(71)	—	—
Other	(11)	(10)	(22)
Sub-Total	32	143	143
Total Income Tax Provision	**$ 736**	**$ 977**	**$ 1,059**
Effective Income Tax Rate	36.6%	41.0%	40.5%

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following is an analysis of deferred income taxes for PSEG:

	As of December 31,	
	2012	2011
	Millions	
Deferred Income Taxes		
Assets:		
Current (net)	$ 49	$ —
Noncurrent:		
Unrecovered Investment Tax Credit	$ 30	$ 15
Accumulated Other Comprehensive Income (Loss)	40	39
Cumulative Effect of a Change in Accounting Principle	11	11
OPEB	200	208
Cost of Removal	51	51
Contractual Liabilities & Environmental Costs	35	35
MTC	18	26
Related to Uncertain Tax Positions	75	104
Capital Loss	35	—
Other	82	44
Total Non-Current Assets	$ 577	$ 533
Total Assets	$ 626	$ 533
Liabilities:		
Current (net)	$ 72	$ 170
Noncurrent:		
Plant-Related Items	$ 4,685	$ 3,894
Nuclear Decommissioning	209	155
New Jersey Corporate Business Tax	343	180
Securitization	371	495
Leasing Activities	656	527
Partnership Activity	17	18
Conservation Costs	101	97
Pension Costs	180	129
AROs	297	302
Taxes Recoverable Through Future Rate (net)	165	158
Total Noncurrent Liabilities	$ 7,024	$ 5,955
Total Liabilities	$ 7,096	$ 6,125
Summary of Accumulated Deferred Income Taxes:		
Net Current Deferred Income Tax Assets	**$ 49**	**$ —**
Net Current Deferred Income Tax Liability	**$ 72**	**$ 170**
Net Noncurrent Deferred Income Tax Liabilities	$ 6,447	$ 5,422
Investment Tax Credit (ITC)	95	36
Net Total Noncurrent Deferred Income Taxes and ITC	**$ 6,542**	**$ 5,458**

Table of Contents

A reconciliation of reported income tax expense for Power with the amount computed by multiplying pre-tax income by the statutory federal income tax rate of 35% is as follows:

	Years Ended December 31,		
	2012	2011	2010
		Millions	
Net Income	$ 647	$ 1,098	$ 1,143
Income (Loss) from Discontinued Operations, net of tax	—	96	7
Income from Continuing Operations	$ 647	$ 1,002	$ 1,136
Income Taxes:			
Operating Income:			
Current Expense:			
Federal	$ 83	$ 400	$ 12
State	53	40	127
Total Current	136	440	139
Deferred Expense:			
Federal	262	151	598
State	35	94	41
Total Deferred	297	245	639
Total Income Taxes	**$ 433**	**$ 685**	**$ 778**
Pre-Tax Income	$ 1,080	$ 1,687	$ 1,914
Tax Computed at Statutory Rate @ 35%	$ 378	$ 591	$ 670
Increase (Decrease) Attributable to Flow-Through of Certain Tax Adjustments:			
State Income Taxes (net of federal income tax)	55	87	109
Manufacturing Deduction	—	(15)	(24)
Nuclear Decommissioning Trust	10	14	10
Uncertain Tax Positions	(6)	11	10
Audit Settlement	(1)	—	—
Other	(3)	(3)	3
Sub-Total	55	94	108
Total Income Tax Provision	**$ 433**	**$ 685**	**$ 778**
Effective Income Tax Rate	40.1%	40.6%	40.6%

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following is an analysis of deferred income taxes for Power:

	As of December 31,	
	2012	2011
	Millions	
Deferred Income Taxes		
Assets:		
Noncurrent:		
Cumulative Effect of a Change in Accounting Principle	$ 11	$ 11
Pension Costs	38	53
Accumulated Other Comprehensive Income (Loss)	40	39
Cost of Removal	51	51
Contractual Liabilities & Environmental Costs	35	35
Related to Uncertain Tax Positions	27	4
Capital Loss	12	—
Other	2	22
Total Noncurrent Assets	$ 216	$ 215
Total Assets	$ 216	$ 215
Liabilities:		
Current (net)	$ 16	$ 53
Noncurrent:		
Plant-Related Items	$ 1,253	$ 1,013
New Jersey Corporate Business Tax	28	7
Nuclear Decommissioning	209	155
AROs	297	302
Total Noncurrent Liabilities	$ 1,787	$ 1,477
Total Liabilities	$ 1,803	$ 1,530
Summary of Accumulated Deferred Income Taxes:		
Net Current Deferred Income Tax Liabilities	**$ 16**	**$ 53**
Net Noncurrent Deferred Income Tax Liabilities	$ 1,571	$ 1,262
Investment Tax Credit (ITC)	4	4
Net Total Noncurrent Deferred Income Taxes and ITC	**$ 1,575**	**$ 1,266**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

A reconciliation of reported income tax expense for PSE&G with the amount computed by multiplying pre-tax income by the statutory federal income tax rate of 35% is as follows:

	Years Ended December 31,		
	2012	2011	2010
	Millions		
Net Income	$ 528	$ 521	$ 358
Preferred Dividends	—	—	(1)
Income from Continuing Operations, excluding Preferred Dividends	$ 528	$ 521	$ 359
Income Taxes:			
Operating Income:			
Current Expense:			
Federal	$ (217)	$ (225)	$ (211)
State	9	(6)	(1)
Total Current	(208)	(231)	(212)
Deferred Expense:			
Federal	409	483	384
State	83	92	63
Total Deferred	492	575	447
Investment Tax Credit	23	(4)	(3)
Total Income Taxes	**$ 307**	**$ 340**	**$ 232**
Pre-Tax Income	$ 835	$ 861	$ 591
Tax Computed at Statutory Rate @ 35%	$ 292	$ 301	$ 207
Increase (Decrease) Attributable to Flow-Through of Certain Tax Adjustments:			
State Income Taxes (net of federal income tax)	52	56	40
Uncertain Tax Positions	7	(1)	(1)
Plant-Related Items	(4)	(6)	(3)
Tax Credits	(3)	(4)	(2)
Audit Settlement	(31)	—	—
Other	(6)	(6)	(9)
Sub-Total	15	39	25
Total Income Tax Provision	**$ 307**	**$ 340**	**$ 232**
Effective Income Tax Rate	36.8%	39.5%	39.2%

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following is an analysis of deferred income taxes for PSE&G:

	As of December 31,	
	2012	2011
	Millions	
Deferred Income Taxes		
Assets:		
Current (net)	$ 49	$ —
Noncurrent:		
Unrecovered ITC	$ 18	$ 10
OPEB	189	197
MTC	18	26
Related to Uncertain Tax Positions	15	30
Other	42	13
Total Noncurrent Assets	$ 282	$ 276
Total Assets	$ 331	$ 276
Liabilities:		
Current (net)	$ 60	$ 32
Noncurrent:		
Plant-Related Items	$ 3,374	$ 2,875
New Jersey Corporate Business Tax	253	146
Securitization	371	495
Conservation Costs	101	97
Pension Costs	189	151
Taxes Recoverable Through Future Rate (net)	165	158
Total Noncurrent Liabilities	$ 4,453	$ 3,922
Total Liabilities	$ 4,513	$ 3,954
Summary of Accumulated Deferred Income Taxes:		
Net Current Deferred Income Tax Assets	**$ 49**	**$ —**
Net Current Deferred Income Tax Liability	**$ 60**	**$ 32**
Net Noncurrent Deferred Income Tax Liability	$ 4,171	$ 3,646
Investment Tax Credit (ITC)	52	29
Net Total Noncurrent Deferred Income Taxes and ITC	**$ 4,223**	**$ 3,675**

As of December 31, 2012, PSE&G had New Jersey State income tax net operating loss (NOL) carryforwards of $1.5 billion, on which a deferred tax asset of $87 million was recorded, which will expire between 2031 and 2033. We believe that it is more-likely-than-not that the benefit from the state NOL carryforwards will be realized.

Each of PSEG, Power and PSE&G provide deferred taxes at the enacted statutory tax rate for all temporary differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities irrespective of the treatment for rate-making purposes. Management believes that it is probable that the accumulated tax benefits that previously have been treated as a flow-through item to PSE&G customers will be recovered from or refunded to PSE&G's customers in the future. These amounts were determined using the enacted federal income tax rate of 35% and state income tax rate of 9%. For additional information, see Note 6. Regulatory Assets and Liabilities.

The Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010 include various health care-related provisions which will go into effect over the next several years. One of the provisions eliminates the tax deductibility of retiree health care costs, to the extent of federal subsidies received by plan sponsors that provide retiree prescription drug benefits equivalent to Medicare Part D coverage. Although this change does not take effect immediately, the accounting impact was required to be recognized when the legislation was signed. As a result, in the first quarter of 2010, PSEG recorded non-cash after tax charges of $9 million for income tax expense to establish the related deferred tax liabilities, primarily related to Power. There was no immediate impact on PSE&G's income tax expense or effective tax rate since the related amount of $78 million was deferred as a Regulatory Asset to be collected and amortized over future periods.

Two other tax provisions were enacted during 2010 that had a significant impact on PSEG's cash position. The Small Business Jobs Act of 2010 extended the tax deduction for 50% bonus depreciation through 2010 for qualified property. The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 included a provision making qualified property placed into service after September 8, 2010 and before January 1, 2012, eligible for 100% bonus depreciation for tax purposes. In addition, qualified property placed into service in 2012 is eligible for 50% bonus depreciation for tax purposes. On January 2, 2013, the President signed into law the American Taxpayer Relief Act of 2012 that further extends 50% bonus depreciation for property placed in service before January 1, 2014. These provisions contain rules which afford certain projects which have a long production period, the benefit of bonus depreciation. These provisions will also generate cash for PSEG through tax benefits related to accelerated depreciation, most of which was realized in 2011. These tax benefits would have otherwise been received over an estimated average 20 year period.

With respect to ITC, for financial statement periods including 2010 and 2011, the law provided an option to claim either a grant or the ITC. Accordingly, in those periods, the ITC was accounted for as a reduction of the book basis of the related assets as opposed to being recorded in tax expense. In 2012 the law changed and the grant option is no longer available; as such, the accumulated deferred ITC generated in 2012 was recorded as a noncurrent deferred tax liability, which was included in Deferred Income Taxes and ITC on PSEG's and PSE&G's Consolidated Balance Sheets as of December 31, 2012.

PSEG recorded the following amounts related to its unrecognized tax benefits, which was primarily comprised of amounts recorded for Power, PSE&G and Energy Holdings:

2012	PSEG	Power	PSE&G	Energy Holdings
		Millions		
Total Amount of Unrecognized Tax Benefits as of January 1, 2012	$ 825	$ 121	$ 113	$ 555
Increases as a Result of Positions Taken in a Prior Period	92	27	55	9
Decreases as a Result of Positions Taken in a Prior Period	(173)	(7)	(47)	(119)
Increases as a Result of Positions Taken during the Current Period	47	3	42	—
Decreases as a Result of Positions Taken during the Current Period	—	—	—	—
Decreases as a Result of Settlements with Taxing Authorities	(389)	(10)	—	(344)
Decreases due to Lapses of Applicable Statute of Limitations	—	—	—	—
Total Amount of Unrecognized Tax Benefits as of December 31, 2012	$ 402	$ 134	$ 163	$ 101
Accumulated Deferred Income Taxes Associated with Unrecognized Tax Benefits	(264)	(93)	(133)	(35)
Regulatory Asset—Unrecognized Tax Benefits	(30)	—	(30)	—
Total Amount of Unrecognized Tax Benefits that if Recognized, would Impact the Effective Tax Rate (including Interest and Penalties)	**$ 108**	**$ 41**	**$ —**	**$ 66**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2011	PSEG	Power	PSE&G	Energy Holdings
		Millions		
Total Amount of Unrecognized Tax Benefits as of January 1, 2011	$ 756	$ 101	$ 82	$ 539
Increases as a Result of Positions Taken in a Prior Period	58	24	14	17
Decreases as a Result of Positions Taken in a Prior Period	(22)	(9)	—	(12)
Increases as a Result of Positions Taken during the Current Period	37	8	18	11
Decreases as a Result of Positions Taken during the Current Period	(4)	(3)	(1)	—
Decreases as a Result of Settlements with Taxing Authorities	—	—	—	—
Decreases due to Lapses of Applicable Statute of Limitations	—	—	—	—
Total Amount of Unrecognized Tax Benefits as of December 31, 2011	$ 825	$ 121	$ 113	$ 555
Accumulated Deferred Income Taxes Associated with Unrecognized Tax Benefits	(379)	(77)	(65)	(213)
Regulatory Asset—Unrecognized Tax Benefits	(20)	—	(20)	—
Total Amount of Unrecognized Tax Benefits that if Recognized, would Impact the Effective Tax Rate (including Interest and Penalties)	**$ 426**	**$ 44**	**$ 28**	**$ 342**

2010	PSEG	Power	PSE&G	Energy Holdings
		Millions		
Total Amount of Unrecognized Tax Benefits as of January 1, 2010	$ 836	$ (42)	$ 35	$ 820
Increases as a Result of Positions Taken in a Prior Period	290	111	79	90
Decreases as a Result of Positions Taken in a Prior Period	(450)	(29)	(38)	(383)
Increases as a Result of Positions Taken during the Current Period	82	63	6	12
Decreases as a Result of Positions Taken during the Current Period	(2)	(2)	—	—
Decreases as a Result of Settlements with Taxing Authorities	—	—	—	—
Decreases due to Lapses of Applicable Statute of Limitations	—	—	—	—
Total Amount of Unrecognized Tax Benefits as of December 31, 2010	$ 756	$ 101	$ 82	$ 539
Accumulated Deferred Income Taxes Associated with Unrecognized Tax Benefits	(332)	(67)	(38)	(204)
Regulatory Asset—Unrecognized Tax Benefits	(16)	—	(16)	—
Total Amount of Unrecognized Tax Benefits that if Recognized, would Impact the Effective Tax Rate (including Interest and Penalties)	**$ 408**	**$ 34**	**$ 28**	**$ 335**

On June 26, 2009, September 15, 2008 and December 17, 2007, PSEG made tax deposits with the IRS in the amount of $140 million, $80 million and $100 million, respectively, to defray potential interest costs associated with disputed tax assessments associated with certain lease investments (see Note 13. Commitments and Contingent Liabilities). The $320 million of deposits were fully refundable and were recorded in Current Accrued Taxes on PSEG's Consolidated Balance Sheets in the years in which the deposits were made, but are not reflected in the amounts shown above. On January 31, 2012, PSEG signed a specific matter closing agreement with the IRS regarding this matter. Based on this agreement, these deposits have been applied against tax and interest due pursuant to the closing agreement.

PSEG and its subsidiaries include all accrued interest and penalties related to uncertain tax positions required to be recorded, as income tax expense. Interest and penalties on uncertain tax positions were as follows:

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	Interest and Penalties on Uncertain Tax Positions Years Ended December 31,		
	2012	2011	2010
		Millions	
Power	$ (2)	$ (11)	$ (17)
PSE&G	1	(24)	(20)
Energy Holdings	39	420	407
Other	—	10	9
Total	**$ 38**	**$ 395**	**$ 379**

It is reasonably possible that total unrecognized tax benefits will decrease within the next twelve months due to either agreements with various taxing authorities upon audit or the expiration of the Statute of Limitations. These potential decreases are as follows:

Possible Decrease in Total Unrecognized Tax Benefits including Interest	Over the next 12 Months
	Millions
PSEG	$ 75
Power	$ 5
PSE&G	$ —

As a result of a change in accounting method for the capitalization of indirect costs, PSEG reduced the net amount of its uncertain tax positions (including interest) by $97 million, approximately $43 million of which related to PSE&G. Pursuant to an agreement signed with the IRS on January 31, 2012, this matter is settled and there will be a resulting increase in uncertain tax positions within the next twelve months. These amounts are not included in the table above.

A description of income tax years that remain subject to examination by material jurisdictions, where an examination has not already concluded are:

	PSEG	Power	PSE&G
United States			
Federal	2007-2011	N/A	N/A
New Jersey	2006-2011	N/A	2006-2011
Pennsylvania	2001-2011	N/A	2000-2011
Connecticut	2002-2011	N/A	N/A
Texas	2007-2011	N/A	N/A
California	2003-2011	N/A	N/A
New York	2009-2011	2009-2011	N/A

Note 21. Earnings Per Share (EPS) and Dividends

EPS

Diluted EPS is calculated by dividing Net Income by the weighted average number of shares of common stock outstanding, including shares issuable upon exercise of stock options outstanding or vesting of restricted stock awards granted under our stock compensation plans and upon payment of performance units or restricted stock units. The following table shows the effect of these stock options, performance units and restricted stock units on the weighted average number of shares outstanding used in calculating diluted EPS:

	Years Ended December 31,					
	2012		2011		2010	
	Basic	Diluted	Basic	Diluted	Basic	Diluted
EPS Numerator:						
(Millions)						
Continuing Operations	$ 1,275	$ 1,275	$ 1,407	$ 1,407	$ 1,557	$ 1,557
Discontinued Operations	—	—	96	96	7	7
Net Income	**$ 1,275**	**$ 1,275**	**$ 1,503**	**$ 1,503**	**$ 1,564**	**$ 1,564**
EPS Denominator:						
(Thousands)						
Weighted Average Common Shares Outstanding	505,933	505,933	505,949	505,949	505,985	505,985
Effect of Stock Based Compensation Awards	—	1,153	—	1,033	—	1,060
Total Shares	**505,933**	**507,086**	**505,949**	**506,982**	**505,985**	**507,045**
EPS:						
Continuing Operations	$ 2.52	$ 2.51	$ 2.78	$ 2.77	$ 3.08	$ 3.07
Discontinued Operations	—	—	0.19	0.19	0.01	0.01
Net Income	**$ 2.52**	**$ 2.51**	**$ 2.97**	**$ 2.96**	**$ 3.09**	**$ 3.08**

There were approximately 1.8 million, 1.8 million and 1.9 million stock options excluded from the weighted average common shares used for diluted EPS due to their antidilutive effect for the years ended December 31, 2012, 2011 and 2010, respectively. No other stock options had an antidilutive effect for the years ended December 31, 2012, 2011 or 2010.

Dividends

	Years Ended December 31,		
Dividend Payments on Common Stock	**2012**	**2011**	**2010**
Per Share	$ 1.42	$ 1.37	$ 1.37
in Millions	$ 718	$ 693	$ 693

On February 19, 2013, PSEG's Board of Directors approved a $ 0.36 per share common stock dividend for the first quarter of 2013.

Note 22. Financial Information by Business Segment

Basis of Organization

PSEG's operating segments are Power, PSE&G and Energy Holdings. The operating segments were determined by management in accordance with GAAP —Disclosures about Segments of an Enterprise and Related Information. These segments were determined based on how management measures performance based on segment Net Income, as illustrated in the following table, and how it allocates resources to each business.

See Note 1. Organization, Basis of Presentation and Summary of Significant Accounting Policies for additional information.

Power

Power earns revenues by selling energy, capacity and ancillary services on a wholesale basis under contract to power marketers and to load serving entities and by bidding energy, capacity and ancillary services into the markets for these products. Power also enters into contracts for energy, capacity, FTRs, gas, emission allowances and other energy-related contracts to optimize the value of its portfolio of generating assets and its electric and gas supply obligations.

PSE&G

PSE&G earns revenues from its tariffs, under which it provides electric transmission and electric and gas distribution services to residential, commercial and industrial customers in New Jersey. The rates charged for electric transmission are regulated by the FERC while the rates charged for electric and gas distribution are regulated by the BPU. Revenues are also earned from several other activities such as sundry sales, the appliance service business, wholesale transmission services and other miscellaneous services.

Energy Holdings

Energy Holdings earns revenues from its solar generation projects and its portfolio of passive investments primarily consisting of domestic leveraged leases. Gains and losses on sales of the lease investments are typically recognized in revenues. Energy Holdings also has equity method generation projects. Earnings from these projects are presented below Operating Income.

Other

Other activities include amounts applicable to PSEG (parent corporation), Services and intercompany eliminations, primarily relating to intercompany transactions between Power and PSE&G. No gains or losses are recorded on any intercompany transactions; rather, all intercompany transactions are at cost or, in the case of the BGS and BGSS contracts between Power and PSE&G, at rates prescribed by the BPU. For a further discussion of the intercompany transactions between Power and PSE&G, see Note 23. Related-Party Transactions. The net losses primarily relate to financing and certain administrative and general costs.

	Power	PSE&G	Energy Holdings	Other	Consolidated Total
			Millions		
Year Ended December 31, 2012					
Operating Revenues	$ 4,865	$ 6,626	$ 113	$ (1,823)	$ 9,781
Depreciation and Amortization	237	778	19	20	1,054
Operating Income (Loss)	1,123	1,083	62	10	2,278
Income from Equity Method Investments	—	—	12	—	12
Interest Income	3	20	2	2	27
Interest Expense	134	295	1	(7)	423
Income (Loss) before Income Taxes	1,080	835	78	18	2,011
Income Tax Expense (Benefit)	433	307	(8)	4	736
Income (Loss) from Continuing Operations	647	528	86	14	1,275
Net Income (Loss)	647	528	86	14	1,275
Segment Earnings (Loss)	647	528	86	14	1,275
Gross Additions to Long-Lived Assets	$ 646	$ 1,770	$ 127	$ 31	$ 2,574
As of December 31, 2012					
Total Assets	$ 11,032	$ 19,223	$ 1,454	$ 16	$ 31,725
Investments in Equity Method Subsidiaries	$ 40	$ —	$ 94	$ —	$ 134

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	Power	PSE&G	Energy Holdings	Other	Consolidated Total
			Millions		
Year Ended December 31, 2011					
Operating Revenues	$ 6,143	$ 7,326	$ (140)	$ (2,250)	$ 11,079
Depreciation and Amortization	224	719	15	18	976
Operating Income (Loss)	1,771	1,151	(197)	17	2,742
Income from Equity Method Investments	—	—	4	—	4
Interest Income	4	12	2	1	19
Interest Expense	175	310	3	(13)	475
Income (Loss) before Income Taxes	1,687	861	(193)	29	2,384
Income Tax Expense (Benefit)	685	340	(59)	11	977
Income (Loss) from Continuing Operations	1,002	521	(134)	18	1,407
Income from Discontinued Operations, net of tax	96	—	—	—	96
Net Income (Loss)	1,098	521	(134)	18	1,503
Segment Earnings (Loss)	1,098	521	(134)	18	1,503
Gross Additions to Long-Lived Assets	$ 757	$ 1,302	$ 4	$ 20	$ 2,083
As of December 31, 2011					
Total Assets	$ 11,087	$ 17,487	$ 1,888	$ (641)	$ 29,821
Investments in Equity Method Subsidiaries	$ 31	$ —	$ 106	$ —	$ 137

	Power	PSE&G	Energy Holdings	Other	Consolidated Total
			Millions		
Year Ended December 31, 2010					
Operating Revenues	$ 6,558	$ 7,869	$ 137	$ (2,771)	$ 11,793
Depreciation and Amortization	175	750	14	16	955
Operating Income (Loss)	1,963	886	81	7	2,937
Income from Equity Method Investments	—	—	4	—	4
Interest Income	3	7	2	8	20
Interest Expense	157	318	11	(14)	472
Income (Loss) before Income Taxes	1,914	591	86	25	2,616
Income Tax Expense (Benefit)	778	232	37	12	1,059
Income (Loss) from Continuing Operations	1,136	359	49	13	1,557
Income from Discontinued Operations, net of tax	7	—	—	—	7
Net Income (Loss)	1,143	359	49	13	1,564
Segment Earnings (Loss)	1,143	358	49	14	1,564
Gross Additions to Long-Lived Assets	$ 825	$ 1,257	$ 63	$ 15	$ 2,160
As of December 31, 2010					
Total Assets	$ 11,452	$ 16,873	$ 2,234	$ (650)	$ 29,909
Investments in Equity Method Subsidiaries	$ 25	$ —	$ 105	$ —	$ 130

Note 23. Related-Party Transactions

The majority of the following discussion relates to intercompany transactions, which are eliminated during the PSEG consolidation process in accordance with GAAP.

Power

The financial statements for Power include transactions with related parties presented as follows:

Related Party Transactions	Years Ended December 31, 2012	2011	2010
	Millions		
Revenue from Affiliates:			
Billings to PSE&G through BGSS (A)	$ 987	$ 1,294	$ 1,591
Billings to PSE&G through BGS (A)	815	921	1,139
Total Revenue from Affiliates	**$ 1,802**	**$ 2,215**	**$ 2,730**
Expense Billings from Affiliates:			
Administrative Billings from Services (B)	$ (154)	$ (147)	$ (145)
Total Expense Billings from Affiliates	**$ (154)**	**$ (147)**	**$ (145)**

Related Party Transactions	Years Ended December 31, 2012	2011
	Millions	
Receivables from PSE&G through BGS and BGSS Contracts (A)	$ 238	$ 247
Receivables from PSE&G Related to Gas Supply Hedges for BGSS (A)	27	109
Receivable from (Payable to) Services (B)	(31)	(26)
Tax Receivable from (Payable to) PSEG (C)	111	58
Receivable from (Payable to) PSEG	(5)	(7)
Accounts Receivable (Payable)—Affiliated Companies, net	**$ 340**	**$ 381**
Short-Term Loan to (from) Affiliate (demand Note to (from) PSEG) (D)	**$ 574**	**$ 907**
Working Capital Advances to Services (E)	**$ 17**	**$ 17**
Long-Term Accrued Taxes Receivable (Payable) (C)	**$ (50)**	**$ (8)**

PSE&G

The financial statements for PSE&G include transactions with related parties presented as follows:

Related Party Transactions	Years Ended December 31, 2012	2011	2010
	Millions		
Expense Billings from Affiliates:			
Billings from Power through BGSS (A)	$ (987)	$ (1,294)	$ (1,591)
Billings from Power through BGS (A)	(815)	(921)	(1,139)
Administrative Billings from Services (B)	(230)	(210)	(206)
Total Expense Billings from Affiliates	**$ (2,032)**	**$ (2,425)**	**$ (2,936)**

Related Party Transactions	Years Ended December 31, 2012	2011
	Millions	
Payable to Power through BGS and BGSS Contracts (A)	$ (238)	$ (247)
Payable to Power Related to Gas Supply Hedges for BGSS (A)	(27)	(109)
Payable to Power from SREC Liability (F)	(7)	(7)
Receivable from (Payable to) Services (B)	(65)	(56)
Tax Receivable from (Payable to) PSEG (C)	256	131
Receivable from (Payable to) PSEG	6	8
Receivable from Energy Holdings	2	—
Accounts Receivable (Payable)—Affiliated Companies, net	**$ (73)**	**$ (280)**
Working Capital Advances to Services (E)	**$ 33**	**$ 33**
Long-Term Accrued Taxes Receivable (Payable) (C)	**$ (32)**	**$ (83)**

(A) PSE&G has a full requirements contract with Power to meet the supply requirements of default service gas customers. This long-term contract was for an initial period which extended through March 31, 2012 and continues on a year-to-year basis thereafter, unless terminated by either party with a one year notice. Power has also entered into contracts to supply energy, capacity and ancillary services to PSE&G through the BGS auction process.

(B) Services provides and bills administrative services to Power and PSE&G at cost. In addition, Power and PSE&G have other payables to Services, including amounts related to certain common costs, such as pension and OPEB costs, which Services pays on behalf of each of the operating companies.

(C) PSEG files a consolidated federal income tax return with its affiliated companies. A tax allocation agreement exists between PSEG and each of its affiliated companies. The general operation of these agreements is that the subsidiary company will compute its taxable income on a stand-alone basis. If the result is a net tax liability, such amount shall be paid to PSEG. If there are net operating losses and/or tax credits, the subsidiary shall receive payment for the tax savings from PSEG to the extent that PSEG is able to utilize those benefits.

(D) Power's short-term loans with PSEG are for working capital and other short-term needs. Interest Income and Interest Expense relating to these short-term funding activities were immaterial.

(E) Power and PSE&G have advanced working capital to Services. The amounts are included in Other Noncurrent Assets on Power's and PSE&G's Consolidated Balance Sheets.

(F) In 2008, the BPU issued a decision that certain BGS suppliers will be reimbursed for the cost they incurred above $300 per Solar Renewable Energy Certificate (SREC) during the period June 1, 2008 through May 31, 2010. The BPU order further provided that the excess cost may be passed on to ratepayers. Following an appeal, on March 10, 2011, the New Jersey Supreme Court reversed and remanded the BPU's 2008 order. On May 1, 2012, the BPU reaffirmed its earlier decision and on December 19, 2012, approved a settlement that defines requirements for review and reimbursement of incremental SREC costs to certain BGS suppliers. PSE&G has estimated and accrued a total liability for the excess SREC cost of $17 million as of December 31, 2012 and 2011, including approximately $7 million for Power's share which is included in PSE&G's Accounts Payable—Affiliated Companies as of December 31, 2012 and 2011. Under current guidance, Power is unable to record the related intercompany receivable on its Consolidated Balance Sheet. As a result, PSE&G's liability to Power is not eliminated in consolidation and is included in Other Current Liabilities on PSEG's Consolidated Balance Sheet as of December 31, 2012 and 2011.

Note 24. Selected Quarterly Data (Unaudited)

The information shown in the following tables, in the opinion of PSEG, Power and PSE&G includes all adjustments, consisting only of normal recurring accruals, necessary to fairly present such amounts.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	Quarter Ended							
	March 31,		June 30,		September 30,		December 31,	
	2012	2011	2012	2011	2012	2011	2012	2011
PSEG Consolidated:	Millions							
Operating Revenues	$ 2,875	$ 3,354	$ 2,098	$ 2,469	$ 2,402	$ 2,620	$ 2,406	$ 2,636
Operating Income	$ 783	$ 856	$ 433	$ 621	$ 594	$ 556	$ 468	$ 709
Income (Loss) from Continuing Operations	$ 493	$ 462	$ 211	$ 320	$ 347	$ 265	$ 224	$ 360
Income (Loss) from Discontinued Operations, including Gain (Loss) on Disposal, net of tax	$ —	$ 64	$ —	$ 3	$ —	$ 29	$ —	$ —
Net Income (Loss)	$ 493	$ 526	$ 211	$ 323	$ 347	$ 294	$ 224	$ 360
Earnings Per Share:								
Basic:								
Income (Loss) from Continuing Operations	$ 0.97	$ 0.91	$ 0.42	$ 0.63	$ 0.69	$ 0.52	$ 0.44	$ 0.71
Net Income (Loss)	$ 0.97	$ 1.04	$ 0.42	$ 0.63	$ 0.69	$ 0.58	$ 0.44	$ 0.71
Diluted:								
Income (Loss) from Continuing Operations	$ 0.97	$ 0.91	$ 0.42	$ 0.63	$ 0.68	$ 0.52	$ 0.44	$ 0.71
Net Income (Loss)	$ 0.97	$ 1.04	$ 0.42	$ 0.63	$ 0.68	$ 0.58	$ 0.44	$ 0.71
Weighted Average Common Shares Outstanding:								
Basic	506	506	506	506	506	506	506	506
Diluted	507	507	507	507	507	507	507	507

	Quarter Ended							
	March 31,		June 30,		September 30,		December 31,	
	2012	2011	2012	2011	2012	2011	2012	2011
Power:	Millions							
Operating Revenues	$ 1,561	$ 1,967	$ 985	$ 1,285	$ 1,038	$ 1,398	$ 1,281	$ 1,493
Operating Income	$ 441	$ 501	$ 196	$ 355	$ 267	$ 483	$ 219	$ 432
Income (Loss) from Continuing Operations	$ 253	$ 298	$ 104	$ 205	$ 181	$ 273	$ 109	$ 226
Income (Loss) from Discontinued Operations, including Gain (Loss) on Disposal, net of tax	$ —	$ 64	$ —	$ 3	$ —	$ 29	$ —	$ —
Net Income (Loss)	$ 253	$ 362	$ 104	$ 208	$ 181	$ 302	$ 109	$ 226

	Quarter Ended							
	March 31,		June 30,		September 30,		December 31,	
	2012	2011	2012	2011	2012	2011	2012	2011
PSE&G:	Millions							
Operating Revenues	$ 1,939	$ 2,306	$ 1,407	$ 1,571	$ 1,683	$ 1,841	$ 1,597	$ 1,608
Operating Income	$ 342	$ 350	$ 227	$ 252	$ 321	$ 328	$ 193	$ 221
Net Income (Loss)	$ 197	$ 163	$ 101	$ 105	$ 155	$ 154	$ 75	$ 99

Note 25. Guarantees of Debt

Power's Senior Notes are fully and unconditionally and jointly and severally guaranteed by its subsidiaries, PSEG Fossil LLC, PSEG Nuclear LLC and PSEG Energy Resources & Trade LLC. The following table presents financial information for the guarantor subsidiaries as well as Power's non-guarantor subsidiaries as of December 31, 2012 and 2011 and for the years ended December 31, 2012, 2011 and 2010.

	Power	Guarantor Subsidiaries	Other Subsidiaries	Consolidating Adjustments	Total
			Millions		
Year Ended December 31, 2012					
Operating Revenues	$ —	$ 6,238	$ 125	$ (1,498)	$ 4,865
Operating Expenses	7	5,118	115	(1,498)	3,742
Operating Income (Loss)	(7)	1,120	10	—	1,123
Equity Earnings (Losses) of Subsidiaries	688	(10)	—	(678)	—
Other Income	45	206	—	(52)	199
Other Deductions	(31)	(59)	—	—	(90)
Other-Than-Temporary Impairments	—	(18)	—	—	(18)
Interest Expense	(118)	(51)	(18)	53	(134)
Income Tax Benefit (Expense)	70	(501)	(2)	—	(433)
Net Income (Loss)	**$ 647**	**$ 687**	**$ (10)**	**$ (677)**	**$ 647**
Comprehensive Income (Loss)	**$ 595**	**$ 681**	**$ (10)**	**$ (671)**	**$ 595**
As of December 31, 2012					
Current Assets	$ 3,922	$ 8,084	$ 940	$ (10,712)	$ 2,234
Property, Plant and Equipment, net	80	5,988	950	—	7,018
Investment in Subsidiaries	4,317	733	—	(5,050)	—
Noncurrent Assets	201	1,660	60	(141)	1,780
Total Assets	**$ 8,520**	**$ 16,465**	**$ 1,950**	**$ (15,903)**	**$ 11,032**
Current Liabilities	$ 482	$ 10,187	$ 1,010	$ (10,712)	$ 967
Noncurrent Liabilities	559	1,960	207	(140)	2,586
Long-Term Debt	2,040	—	—	—	2,040
Member's Equity	5,439	4,318	733	(5,051)	5,439
Total Liabilities and Member's Equity	**$ 8,520**	**$ 16,465**	**$ 1,950**	**$ (15,903)**	**$ 11,032**
Year Ended December 31, 2012					
Net Cash Provided By (Used In) Operating Activities	$ 298	$ 1,562	$ (7)	$ (474)	$ 1,379
Net Cash Provided By (Used In) Investing Activities	$ 715	$ (1,206)	$ (27)	$ 170	$ (348)
Net Cash Provided By (Used In) Financing Activities	$ (1,013)	$ (361)	$ 33	$ 305	$ (1,036)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	Power	Guarantor Subsidiaries	Other Subsidiaries	Consolidating Adjustments	Total
			Millions		
Year Ended December 31, 2011					
Operating Revenues	$ —	$ 7,452	$ 146	$ (1,455)	$ 6,143
Operating Expenses	5	5,673	150	(1,456)	4,372
Operating Income (Loss)	(5)	1,779	(4)	1	1,771
Equity Earnings (Losses) of Subsidiaries	1,175	92	—	(1,267)	—
Other Income	40	195	—	(45)	190
Other Deductions	(28)	(51)	—	—	(79)
Other-Than-Temporary Impairments	(1)	(19)	—	—	(20)
Interest Expense	(146)	(56)	(18)	45	(175)
Income Tax Benefit (Expense)	63	(762)	14	—	(685)
Income (Loss) on Discontinued Operations, net of Tax Benefit	—	—	97	(1)	96
Net Income (Loss)	**$ 1,098**	**$ 1,178**	**$ 89**	**$ (1,267)**	**$ 1,098**
Comprehensive Income (Loss)	**$ 917**	**$ 1,055**	**$ 89**	**$ (1,144)**	**$ 917**
As of December 31, 2011					
Current Assets	$ 4,311	$ 7,248	$ 951	$ (9,823)	$ 2,687
Property, Plant and Equipment, net	66	5,715	950	—	6,731
Investment in Subsidiaries	4,185	804	—	(4,989)	—
Noncurrent Assets	179	1,557	51	(118)	1,669
Total Assets	**$ 8,741**	**$ 15,324**	**$ 1,952**	**$ (14,930)**	**$ 11,087**
Current Liabilities	$ 172	$ 9,549	$ 1,003	$ (9,822)	$ 902
Noncurrent Liabilities	440	1,589	145	(118)	2,056
Long-Term Debt	2,685	—	—	—	2,685
Member's Equity	5,444	4,186	804	(4,990)	5,444
Total Liabilities and Member's Equity	**$ 8,741**	**$ 15,324**	**$ 1,952**	**$ (14,930)**	**$ 11,087**
Year Ended December 31, 2011					
Net Cash Provided By (Used In) Operating Activities	$ 609	$ 2,427	$ (284)	$ (940)	$ 1,812
Net Cash Provided By (Used In) Investing Activities	$ 596	$ (1,171)	$ 594	$ (597)	$ (578)
Net Cash Provided By (Used In) Financing Activities	$ (1,205)	$ (1,256)	$ (309)	$ 1,537	$ (1,233)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	Power	Guarantor Subsidiaries	Other Subsidiaries	Consolidating Adjustments	Total
			Millions		
Year Ended December 31, 2010					
Operating Revenues	$ —	$ 7,746	$ 125	$ (1,313)	$ 6,558
Operating Expenses	9	5,760	139	(1,313)	4,595
Operating Income (Loss)	(9)	1,986	(14)	—	1,963
Equity Earnings (Losses) of Subsidiaries	1,182	(15)	—	(1,167)	—
Other Income	45	170	—	(45)	170
Other Deductions	(4)	(49)	—	—	(53)
Other-Than-Temporary Impairments	—	(9)	—	—	(9)
Interest Expense	(113)	(67)	(22)	45	(157)
Income Tax Benefit (Expense)	42	(834)	14	—	(778)
Income (Loss) on Discontinued Operations, net of Tax Benefit	—	—	7	—	7
Net Income (Loss)	**$ 1,143**	**$ 1,182**	**$ (15)**	**$ (1,167)**	**$ 1,143**
Comprehensive Income (Loss)	**$ 1,109**	**$ 1,130**	**$ (15)**	**$ (1,115)**	**$ 1,109**
Year Ended December 31, 2010					
Net Cash Provided By (Used In) Operating Activities	$ 467	$ 2,249	$ 28	$ (1,178)	$ 1,566
Net Cash Provided By (Used In) Investing Activities	$ (252)	$ (1,567)	$ (34)	$ 648	$ (1,205)
Net Cash Provided By (Used In) Financing Activities	$ (216)	$ (687)	$ (40)	$ 529	$ (414)

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

PSEG, Power and PSE&G

We have established and maintain disclosure controls and procedures as defined under Rule 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended (Exchange Act) that are designed to provide reasonable assurance that information required to be disclosed in the reports that are filed or submitted under the Exchange Act is recorded, processed, summarized and reported and is accumulated and communicated to the Chief Executive Officer and Chief Financial Officer of each respective company, as appropriate, by others within the entities to allow timely decisions regarding required disclosure. We have established a disclosure committee which includes several key management employees and which reports directly to the Chief Financial Officer and Chief Executive Officer of each respective company. The committee monitors and evaluates the effectiveness of these disclosure controls and procedures. The Chief Financial Officer and Chief Executive Officer of each company have evaluated the effectiveness of the disclosure controls and procedures and, based on this evaluation, have concluded that disclosure controls and procedures at each respective company were effective at a reasonable assurance level as of the end of the period covered by the report.

Internal Controls

PSEG, Power and PSE&G

We have conducted assessments of our internal control over financial reporting as of December 31, 2012, as required by Section 404 of the Sarbanes-Oxley Act, using the framework promulgated by the Committee of Sponsoring Organizations of the Treadway Commission, commonly referred to as “COSO”. Management’s reports on PSEG’s, Power’s and PSE&G’s internal control over financial reporting are included on pages 173, 174 and 175, respectively. The Independent Registered Public Accounting Firm’s report with respect to the effectiveness of PSEG’s internal control over financial reporting is included on page 176. Management has concluded that internal control over financial reporting is effective as of December 31, 2012.

We continually review our disclosure controls and procedures and make changes, as necessary, to ensure the quality of their financial reporting. There have been no changes in internal control over financial reporting that occurred during the fourth quarter of 2012 that have materially affected, or are reasonably likely to materially affect, each registrant’s internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

MANAGEMENT REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING—PSEG

Management of Public Service Enterprise Group (PSEG) is responsible for establishing and maintaining effective internal control over financial reporting and for the assessment of the effectiveness of internal control over financial reporting. As defined by the SEC in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and implemented by the company's management and other personnel, with oversight by the Audit Committee of the Board of Directors to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America (generally accepted accounting principles).

PSEG's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of PSEG's assets; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of PSEG are being made only in accordance with authorizations of PSEG's management and directors; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of PSEG's assets that could have a material effect on the financial statements.

In connection with the preparation of PSEG's annual financial statements, management of PSEG has undertaken an assessment, which includes the design and operational effectiveness of PSEG's internal control over financial reporting using the framework promulgated by the Committee of Sponsoring Organizations of the Treadway Commission, commonly referred to as "COSO". The COSO framework is based upon five integrated components of control: control environment, risk assessment, control activities, information and communications and ongoing monitoring.

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

Based on the assessment performed, management has concluded that PSEG's internal control over financial reporting is effective and provides reasonable assurance regarding the reliability of PSEG's financial reporting and the preparation of its financial statements as of December 31, 2012 in accordance with generally accepted accounting principles. Further, management has not identified any material weaknesses in internal control over financial reporting as of December 31, 2012.

PSEG's external auditors, Deloitte & Touche LLP, have audited PSEG's financial statements for the year ended December 31, 2012 included in this annual report on Form 10-K and, as part of that audit, have issued a report on the effectiveness of PSEG's internal control over financial reporting, a copy of which is included in this annual report on Form 10-K.

/S/ RALPH IZZO

Chief Executive Officer

/s/ CAROLINE DORSA

Chief Financial Officer
February 25, 2013

MANAGEMENT REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING—Power

Management of PSEG Power LLC (Power) is responsible for establishing and maintaining effective internal control over financial reporting and for the assessment of the effectiveness of internal control over financial reporting. As defined by the SEC in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and implemented by the company's management and other personnel, with oversight by the Audit Committee of the Board of Directors of its parent, Public Service Enterprise Group Incorporated, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America (generally accepted accounting principles).

Power's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of Power's assets; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of Power are being made only in accordance with authorizations of Power's management and directors; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of Power's assets that could have a material effect on the financial statements.

In connection with the preparation of Power's annual financial statements, management of Power has undertaken an assessment, which includes the design and operational effectiveness of Power's internal control over financial reporting using the framework promulgated by the Committee of Sponsoring Organizations of the Treadway Commission, commonly referred to as "COSO". The COSO framework is based upon five integrated components of control: control environment, risk assessment, control activities, information and communications and ongoing monitoring.

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

Based on the assessment performed, management has concluded that Power's internal control over financial reporting is effective and provides reasonable assurance regarding the reliability of Power's financial reporting and the preparation of its financial statements as of December 31, 2012 in accordance with generally accepted accounting principles. Further, management has not identified any material weaknesses in internal control over financial reporting as of December 31, 2012.

/s/ RALPH IZZO
Chief Executive Officer

/s/ CAROLINE DORSA
Chief Financial Officer

February 25, 2013

MANAGEMENT REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING—PSE&G

Management of Public Service Electric and Gas Company (PSE&G) is responsible for establishing and maintaining effective internal control over financial reporting and for the assessment of the effectiveness of internal control over financial reporting. As defined by the SEC in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and implemented by the company's management and other personnel, with oversight by the Audit Committee of the Board of Directors of its parent, Public Service Enterprise Group Incorporated, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America (generally accepted accounting principles).

PSE&G's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of PSE&G's assets; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of PSE&G are being made only in accordance with authorizations of PSE&G's management and directors; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of PSE&G's assets that could have a material effect on the financial statements.

In connection with the preparation of PSE&G's annual financial statements, management of PSE&G has undertaken an assessment, which includes the design and operational effectiveness of PSE&G's internal control over financial reporting using the framework promulgated by the Committee of Sponsoring Organizations of the Treadway Commission, commonly referred to as "COSO". The COSO framework is based upon five integrated components of control: control environment, risk assessment, control activities, information and communications and ongoing monitoring.

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

Based on the assessment performed, management has concluded that PSE&G's internal control over financial reporting is effective and provides reasonable assurance regarding the reliability of PSE&G's financial reporting and the preparation of its financial statements as of December 31, 2012 in accordance with generally accepted accounting principles. Further, management has not identified any material weaknesses in internal control over financial reporting as of December 31, 2012.

/s/ RALPH IZZO

Chief Executive Officer

/s/ CAROLINE DORSA

Chief Financial Officer

February 25, 2013

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and Board of Directors of

Public Service Enterprise Group Incorporated:

We have audited the internal control over financial reporting of Public Service Enterprise Group Incorporated and subsidiaries (the "Company") as of December 31, 2012, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management Report on Internal Control Over Financial Reporting-PSEG. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2012, based on the criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements and consolidated financial statement schedule listed in the Index at Item 15(B)(a) as of and for the year ended December 31, 2012 of the Company and our report dated February 25, 2013 expressed an unqualified opinion on those consolidated financial statements and consolidated financial statement schedule.

/s/ DELOITTE & TOUCHE LLP

Parsippany, New Jersey
February 25, 2013

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

Executive Officers

PSEG

Name	Age as of December 31, 2012	Office	Effective Date First Elected to Present Position
Ralph Izzo	5 5	Chairman of the Board, President and Chief Executive Officer (PSEG)	April 2007 to present
		Chairman of the Board and Chief Executive Officer (Power)	April 2007 to present
		Chairman of the Board and Chief Executive Officer (PSE&G)	April 2007 to present
		Chairman of the Board and Chief Executive Officer (Energy Holdings)	April 2007 to present
		Chairman of the Board, President and Chief Executive Officer (Services)	January 2010 to present
		Chairman of the Board and Chief Executive Officer (Services)	April 2007 to January 2010
		President and Chief Operating Officer (PSEG)	October 2006 to March 2007
Caroline Dorsa	53	Executive Vice President and Chief Financial Officer (PSEG)	April 2009 to present
		Executive Vice President and Chief Financial Officer (Power)	April 2009 to present
		Executive Vice President and Chief Financial Officer (PSE&G)	April 2009 to present
		Chief Financial Officer (Energy Holdings)	April 2009 to present
		Executive Vice President and Chief Financial Officer (Services)	April 2009 to present
		Senior Vice President, Global Human Health Strategy and Integration (Merck and Co., Inc.)	January 2008 to April 2009
		Senior Vice President and Chief Financial Officer (Gilead Sciences, Inc.)	November 2007 to January 2008
		Senior Vice President and Chief Financial Officer (Avaya, Inc.)	February 2007 to November 2007
William Levis	5 6	President and Chief Operating Officer (Power)	June 2007 to present
		President and Chief Nuclear Officer (Nuclear)	January 2007 to October 2008
Ralph LaRossa	49	President and Chief Operating Officer (PSE&G)	October 2006 to present

Name	Age as of December 31, 2012	Office	Effective Date First Elected to Present Position
Derek M. DiRisio	48	Vice President and Controller (PSEG)	January 2007 to present
		Vice President and Controller (PSE&G)	January 2007 to present
		Vice President and Controller (Power)	January 2007 to present
		Vice President and Controller (Energy Holdings)	January 2007 to present
		Vice President and Controller (Services)	January 2007 to present
		Assistant Controller Enterprise (Services)	July 2004 to January 2007
Randall E. Mehrberg	57	President and Chief Operating Officer (Energy Holdings)	June 2009 to present
		Executive Vice President—Strategy and Development (Services)	April 2009 to present
		Executive Vice President—Planning and Strategy (Services)	September 2008 to April 2009
		Various positions, last being Executive Vice President, Chief Administrative Officer and Chief Legal Officer (Exelon Corporation)	2000 to June 2008
J.A. Bouknight, Jr.	68	Executive Vice President and General Counsel (PSEG)	January 2010 to present
		Executive Vice President and General Counsel (Power)	January 2010 to present
		Executive Vice President and General Counsel (PSE&G)	January 2010 to present
		Executive Vice President and General Counsel (Services)	January 2010 to present
		Partner, Steptoe & Johnson LLP	July 2008 to November 2009
		Executive Vice President and General Counsel (Edison International)	July 2005 to July 2008

Power and PSE&G

Omitted pursuant to conditions set forth in General Instruction I of Form 10-K.

Directors

PSEG

The information required by Item 10 of Form 10-K with respect to (i) present directors of PSEG who are nominees for election as directors at PSEG’s 2013 Annual Meeting of Stockholders, and (ii) compliance with Section 16(a) of the Securities Exchange Act of 1934, as amended, is set forth under the headings ‘Election of Directors’ and “Section 16(a) Beneficial Ownership Reporting Compliance” in PSEG’s definitive Proxy Statement for such Annual Meeting of Stockholders, which definitive Proxy Statement is expected to be filed with the U.S. Securities and Exchange Commission (SEC) on or about March 8, 2013 and which information set forth under said heading is incorporated herein by this reference thereto.

Power and PSE&G

Omitted pursuant to conditions set forth in General Instruction I of Form 10-K.

Code of Ethics

Our Standards of Integrity (Standards) is a code of ethics applicable to us and our subsidiaries. The Standards are an integral part of our business conduct compliance program and embody our commitment to conduct operations in accordance with the highest legal and ethical standards. The Standards apply to all of our directors and employees (including Power’s, PSE&G’s,

Energy Holdings' and Services' respective principal executive officer, principal financial officer, principal accounting officer or Controller and persons performing similar functions). Each such person is responsible for understanding and complying with the Standards. The Standards are posted on our website, www.pseg.com/info/investors/governance/document.jsp. We will send you a copy on request.

The Standards establish a set of common expectations for behavior to which each employee must adhere in dealings with investors, customers, fellow employees, competitors, vendors, government officials, the media and all others who may associate their words and actions with us. The Standards have been developed to provide reasonable assurance that, in conducting our business, employees behave ethically and in accordance with the law and do not take advantage of investors, regulators or customers through manipulation, abuse of confidential information or misrepresentation of material facts.

We will post on our website, www.pseg.com/info/investors/governance/document.jsp:

- Any amendment (other than one that is technical, administrative or non-substantive) that we adopt to our Standards; and
- Any grant by us of a waiver from the Standards that applies to any director, principal executive officer, principal financial officer, principal accounting officer or Controller, or persons performing similar functions, for us or our direct subsidiaries noted above, and that relates to any element enumerated by the SEC.

In 2012, we did not grant any waivers to the Standards.

ITEM 11. EXECUTIVE COMPENSATION

PSEG

The information required by Item 11 of Form 10-K is set forth in PSEG's definitive Proxy Statement for the 2013 Annual Meeting of Stockholders which definitive Proxy Statement is expected to be filed with the U.S. Securities and Exchange Commission (SEC) on or about March 8, 2013 and such information set forth under such heading is incorporated herein by this reference thereto.

Section 16 Beneficial Ownership Reporting Compliance

During 2012, none of our directors or executive officers was late in filing a Form 3, 4 or 5 in accordance with the requirements of Section 16(a) of the Securities Exchange Act of 1934, as amended, with regard to transactions involving our Common Stock, with the exception of Susan Tomasky, one of our Directors. Ms. Tomasky filed one late report on Form 3 to report any ownership by her of our Common Stock at the time of her election to the Board. At that time, Ms. Tomasky did not own any of our Common Stock.

Power and PSE&G

Omitted pursuant to conditions set forth in General Instruction I of Form 10-K.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDERS MATTERS

PSEG

The information required by Item 12 of Form 10-K with respect to directors, executive officers and certain beneficial owners is set forth under the heading "Security Ownership of Directors, Management and Certain Beneficial Owners" in PSEG's definitive Proxy Statement for the 2013 Annual Meeting of Stockholders which definitive Proxy Statement is expected to be filed with the SEC on or about March 8, 2013, and such information set forth under such heading is incorporated herein by this reference thereto.

For information relating to securities authorized for issuance under equity compensation plans, see Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Power and PSE&G

Omitted pursuant to conditions set forth in General Instruction I of Form 10-K.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

PSEG

The information required by Item 13 of Form 10-K is set forth under the heading “Transactions with Related Persons” in PSEG’s definitive Proxy Statement for the 2013 Annual Meeting of Stockholders which definitive Proxy Statement is expected to be filed with the SEC on or about March 8, 2013 and such information set forth under such heading is incorporated herein by this reference thereto.

Power and PSE&G

Omitted pursuant to conditions set forth in General Instruction I of Form 10K.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by Item 14 of Form 10-K is set forth under the heading “Fees Billed to PSEG by Deloitte & Touche LLP for 2012 and 2011” in PSEG’s definitive Proxy Statement for the 2013 Annual Meeting of Stockholders which definitive Proxy Statement is expected to be filed with the SEC on or about March 8, 2013. Such information set forth under such heading is incorporated herein by this reference hereto.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(A) The following Financial Statements are filed as a part of this report:

a. Public Service Enterprise Group Incorporated’s Consolidated Balance Sheets as of December 31, 2012 and 2011 and the related Consolidated Statements of Operations, Comprehensive Income, Cash Flows and Stockholders’ Equity for the three years ended December 31, 2012 on pages 74 through 79.

b. PSEG Power LLC’s Consolidated Balance Sheets as of December 31, 2012 and 2011 and the related Consolidated Statements of Operations, Comprehensive Income, Cash Flows and Capitalization and Member’s Equity for the three years ended December 31, 2012 on pages 80 through 85.

c. Public Service Electric and Gas Company’s Consolidated Balance Sheets as of December 31, 2012 and 2011 and the related Consolidated Statements of Operations, Comprehensive Income, Cash Flows and Common Stockholders’ Equity for the three years ended December 31, 2012 on pages 86 through 91.

(B) The following documents are filed as a part of this report:

a. PSEG's Financial Statement Schedules:

Schedule II—Valuation and Qualifying Accounts for each of the three years in the period ended December 31, 2012 (page 189).

b. Power's Financial Statement Schedules:

Schedule II—Valuation and Qualifying Accounts for each of the three years in the period ended December 31, 2012 (page 189).

c. PSE&G's Financial Statement Schedules:

Schedule II—Valuation and Qualifying Accounts for each of the three years in the period ended December 31, 2012 (page 190).

Schedules other than those listed above are omitted for the reason that they are not required or are not applicable, or the required information is shown in the consolidated financial statements or notes thereto.

(C) The following documents are filed as part of this report:

LIST OF EXHIBITS:

a.	**PSEG:**
3a	Certificate of Incorporation Public Service Enterprise Group Incorporated (1)
3b	By-Laws of Public Service Enterprise Group Incorporated effective November 17, 2009 (2)
3c	Certificate of Amendment of Certificate of Incorporation of Public Service Enterprise Group Incorporated, effective April 23, 1987 (3)
3d	Certificate of Amendment of Certificate of Incorporation of Public Service Enterprise Group Incorporated, effective April 20, 2007 (4)
4a(1)	Indenture between Public Service Enterprise Group Incorporated and First Union National Bank (U.S. Bank National Association, successor), as Trustee, dated January 1, 1998 providing for Deferrable Interest Subordinated Debentures in Series (relating to Quarterly Preferred Securities)(5)
9	Inapplicable
10a(1)	Supplemental Executive Retirement Income Plan, effective as of May 31, 2011 (6)
10a(2)	Retirement Income Reinstatement Plan for Non-Represented Employees as amended May 31, 2011 (7)
10a(3)	Employment Agreement with William Levis dated December 8, 2006 (8)
10a(4)	Amended and Restated 2007 Equity Compensation Plan for Outside Directors, effective July 19, 2011 (9)
10a(5)	Employee Stock Purchase Plan (10)
10a(6)	Deferred Compensation Plan for Directors, amended July 19, 2011 (11)
10a(7)	Deferred Compensation Plan for Certain Employees, amended November 1, 2011 (75)
10a(8)	1989 Long-Term Incentive Plan, as amended (13)
10a(9)	2001 Long-Term Incentive Plan (14)
10a(10)	Senior Management Incentive Compensation Plan (15)
10a(11)	Amended and Restated Key Executive Severance Plan, amended effective December 17, 2012
10a(12)	Severance Agreement with Ralph Izzo dated December 16, 2008 (16)
10a(13)	Employment Agreement with Randall Mehrberg dated June 30, 2008 (17)
10a(14)	Employment Agreement with Caroline Dorsa dated March 11, 2009, as amended April 24, 2009 (18)
10a(15)	Stock Plan for Outside Directors, as amended (19)
10a(16)	Compensation Plan for Outside Directors (20)
10a(17)	2004 Long-Term Incentive Plan, amended effective December 1, 2009 (21)
10a(18)	Form of Advancement of Expenses Agreement with Outside Directors (22)
10a(19)	Equity Deferral Plan, effective November 1, 2011, amended December 9, 2011 (76)
10a(20)	Employment Agreement with J.A. Bouknight dated August 26, 2009 (77)
10a(21)	Amendment to Employment Agreement with Randall Mehrberg, dated May 3, 2011 (72)
10a(22)	Amendment to Employment Agreement with Caroline Dorsa, dated July 12, 2011 (73)
10a(23)	Amendment to Employment Agreement with Randall Mehrberg, dated June 8, 2011 (74)
10a(24)	Amendment to Employment Agreement with William Levis, dated September 19, 2011 (12)

LIST OF EXHIBITS:

10a(25)	Amendment to Employment Agreement with J.A. Bouknight dated November 19, 2012 [78]
11	Inapplicable
12	Computation of Ratios of Earnings to Fixed Charges
13	Inapplicable
16	Inapplicable
18	Inapplicable
21	Subsidiaries of the Registrant
22	Inapplicable
23	Consent of Independent Registered Public Accounting Firm
24	Inapplicable
31	Certification by Ralph Izzo, pursuant to Rules 13a-14 and 15d-14 of the Securities Exchange Act of 1934 (1934 Act)
31a	Certification by Caroline Dorsa, pursuant to Rules 13a-14 and 15d-14 of the 1934 Act
32	Certification by Ralph Izzo, pursuant to Section 1350 of Chapter 63 of Title 18 of the U.S. Code
32a	Certification by Caroline Dorsa, pursuant to Section 1350 of Chapter 63 of Title 18 of the U.S. Code
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema
101.CAL	XBRL Taxonomy Calculation Linkbase
101.LAB	XBRL Taxonomy Extension Labels Linkbase
101.PRE	XBRL Taxonomy Extension Presentation Linkbase
101.DEF	XBRL Taxonomy Extension Definition Document
b.	**Power:**
3a	Certificate of Formation of PSEG Power LLC [23]
3b	PSEG Power LLC Limited Liability Company Agreement [24]
3c	Trust Agreement for PSEG Power Capital Trust I [25]
3d	Trust Agreement for PSEG Power Capital Trust II [26]
3e	Trust Agreement for PSEG Power Capital Trust III [27]
3f	Trust Agreement for PSEG Power Capital Trust IV [28]
3g	Trust Agreement for PSEG Power Capital Trust V [29]
4a	Indenture dated April 16, 2001 between and among PSEG Power, PSEG Fossil, PSEG Nuclear, PSEG Energy Resources & Trade and The Bank of New York Mellon and form of Subsidiary Guaranty included therein [30]
4b	First Supplemental Indenture, supplemental to Exhibit 4a, dated as of March 13, 2002 [31]
10a(1)	Supplemental Executive Retirement Income Plan, effective as of May 31, 2011 [6]
10a(2)	Retirement Income Reinstatement Plan for Non-Represented Employees, as amended May 31, 2011 [7]
10a(3)	Employment Agreement with William Levis dated December 8, 2006 [8]
10a(4)	Employee Stock Purchase Plan [10]
10a(5)	Deferred Compensation Plan for Certain Employees, amended November 1, 2011 [75]
10a(6)	1989 Long-Term Incentive Plan, as amended [13]
10a(7)	2001 Long-Term Incentive Plan [14]
10a(8)	Senior Management Incentive Compensation Plan [15]

LIST OF EXHIBITS:

10a(9)	Amended and Restated Key Executive Severance Plan, amended effective December 17, 2012
10a(10)	Severance Agreement with Ralph Izzo dated December 16, 2008 [16]
10a(11)	Employment Agreement with Caroline Dorsa dated March 11, 2009, as amended April 24, 2009 [18]
10a(12)	2004 Long-Term Incentive Plan, amended effective December 1, 2009 [21]
10a(19)	Equity Deferral Plan, effective November 1, 2011, amended December 9, 2011 [76]
10a(20)	Employment Agreement with J.A. Bouknight dated August 26, 2009 [77]
10a(21)	Amendment to Employment Agreement with Caroline Dorsa, dated July 12, 2011 [73]
10a(22)	Amendment to Employment Agreement with William Levis, dated September 19, 2011 [12]
10a(23)	Amendment to Employment Agreement with J.A. Bouknight dated November 19, 2012 [78]
11	Inapplicable
12a	Computation of Ratio of Earnings to Fixed Charges
13	Inapplicable
16	Inapplicable
18	Inapplicable
19	Inapplicable
23a	Consent of Independent Registered Public Accounting Firm
24	Inapplicable
31b	Certification by Ralph Izzo, pursuant to Rules 13a-14 and 15d-14 of the 1934 Act
31c	Certification by Caroline Dorsa, pursuant to Rules 13a-14 and 15d-14 of the 1934 Act
32b	Certification by Ralph Izzo, pursuant to Section 1350 of Chapter 63 of Title 18 of the U.S. Code
32c	Certification by Caroline Dorsa, pursuant to Section 1350 of Chapter 63 of Title 18 of the U.S. Code
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema
101.CAL	XBRL Taxonomy Calculation Linkbase
101.LAB	XBRL Taxonomy Extension Labels Linkbase
101.PRE	XBRL Taxonomy Extension Presentation Linkbase
101.DEF	XBRL Taxonomy Extension Definition Document
c.	**PSE&G**
3a(1)	Restated Certificate of Incorporation of PSE&G [32]
3a(2)	Certificate of Amendment of Certificate of Restated Certificate of Incorporation of PSE&G filed February 18, 1987 with the State of New Jersey adopting limitations of liability provisions in accordance with an amendment to New Jersey Business Corporation Act [33]
3a(3)	Certificate of Amendment of Restated Certificate of Incorporation of PSE&G filed June 17, 1992 with the State of New Jersey, establishing the 7.44% Cumulative Preferred Stock ($100 Par) as a series of Preferred Stock [34]
3a(4)	Certificate of Amendment of Restated Certificate of Incorporation of PSE&G filed March 11, 1993 with the State of New Jersey, establishing the 5.97% Cumulative Preferred Stock ($100 Par) as a series of Preferred Stock [35]
3a(5)	Certificate of Amendment of Restated Certificate of Incorporation of PSE&G filed January 27, 1994 with the State of New Jersey, establishing the 6.92% Cumulative Preferred Stock ($100 Par) and the 6.75% Cumulative Preferred Stock ($25 Par) as a series of Preferred Stock [36]
3b(1)	By-Laws of PSE&G as in effect April 17, 2007 [37]

LIST OF EXHIBITS:

4a(1)	Indenture between PSE&G and Fidelity Union Trust Company (now, Wachovia Bank, National Association), as Trustee, dated August 1, 1924[38], securing First and Refunding Mortgage Bond and Supplemental Indentures between PSE&G and U.S. Bank National Association, successor, as Trustee, supplemental to Exhibit 4a(1), dated as follows:
4a(2)	April 1, 1927[39]
4a(3)	June 1, 1937[40]
4a(4)	July 1, 1937[41]
4a(5)	December 19, 1939[42]
4a(6)	March 1, 1942[43]
4a(7)	June 1, 1991 (No. 1)[44]
4a(8)	July 1, 1993[45]
4a(9)	September 1, 1993[46]
4a(10)	February 1, 1994[47]
4a(11)	March 1, 1994 (No. 2)[48]
4a(12)	May 1, 1994[49]
4a(13)	October 1, 1994 (No. 2)[50]
4a(14)	January 1, 1996 (No. 1)[51]
4a(15)	January 1, 1996 (No. 2)[52]
4a(16)	May 1, 1998[53]
4a(17)	September 1, 2002[54]
4a(18)	August 1, 2003[55]
4a(19)	December 1, 2003 (No. 1)[56]
4a(20)	December 1, 2003 (No. 2)[57]
4a(21)	December 1, 2003 (No. 3)[58]
4a(22)	December 1, 2003 (No. 4)[59]
4a(23)	June 1, 2004[60]
4a(24)	August 1, 2004 (No. 1)[61]
4a(25)	August 1, 2004 (No. 2)[62]
4a(26)	August 1, 2004 (No. 3)[63]
4a(27)	August 1, 2004 (No. 4)[64]
4a(28)	April 1, 2007[65]
4a(29)	November 1, 2008[66]
4a(30)	November 1, 2009[67]
4a(31)	October 1, 2010[68]
4a(32)	May 1, 2012
4a(33)	June 1, 2012
4b	Indenture of Trust between PSE&G and Chase Manhattan Bank (National Association) (The Bank of New York Mellon, successor), as Trustee, providing for Secured medium-Term Notes dated July 1, 1993 [69]
4c	Indenture dated as of December 1, 2000 between Public Service Electric and Gas Company and First Union National Bank (U.S. Bank National Association, successor), as Trustee, providing for Senior Debt Securities [70]
10a(1)	Supplemental Executive Retirement Income Plan, effective as of May 31, 2011 [6]
10a(2)	Retirement Income Reinstatement Plan for Non-Represented Employees as amended May 31, 2011 [7]

LIST OF EXHIBITS:

10a(3)	Amended and Restated 2007 Equity Compensation Plan for Outside Directors, effective July 19, 2011 [9]
10a(4)	Employee Stock Purchase Plan [10]
10a(5)	Deferred Compensation Plan for Directors, amended July 19, 2011 [11]
10a(6)	Deferred Compensation Plan for Certain Employees, amended November 1, 2011
10a(7)	1989 Long-Term Incentive Plan, as amended [13]
10a(8)	2001 Long-Term Incentive Plan [14]
10a(9)	Senior Management Incentive Compensation Plan [15]
10a(10)	Amended and Restated Key Executive Severance Plan, amended effective December 17, 2012
10a(11)	Severance Agreement with Ralph Izzo dated December 16, 2008 [16]
10a(12)	Employment Agreement with Caroline Dorsa dated March 11, 2009, as amended April 24, 2009 [18]
10a(13)	Stock Plan for Outside Directors, as amended [19]
10a(14)	Compensation Plan for Outside Directors [20]
10a(15)	2004 Long-Term Incentive Plan, amended effective December 1, 2009 [21]
10a(16)	Form of Advancement of Expenses Agreement with Outside Directors [71]
10a(19)	Equity Deferral Plan, effective November 1, 2011, amended December 9, 2011
10a(20)	Employment Agreement with J.A. Bouknight dated August 26, 2009
10a(21)	Amendment to Employment Agreement with Caroline Dorsa, dated July 12, 2011 [73]
10a(22)	Amendment to Employment Agreement with J.A. Bouknight dated November 19, 2012 [78]
11	Inapplicable
12b	Computation of Ratios of Earnings to Fixed Charges
12c	Computation of Ratios of Earnings to Fixed Charges Plus Preferred Stock Dividend Requirements
13	Inapplicable
16	Inapplicable
18	Inapplicable
19	Inapplicable
23b	Consent of Independent Registered Public Accounting Firm
24	Inapplicable
31d	Certification by Ralph Izzo, pursuant to Rules 13a-14 and 15d-14 of the 1934 Act
31e	Certification by Caroline Dorsa, pursuant to Rules 13a-14 and 15d-14 of the 1934 Act
32d	Certification by Ralph Izzo, pursuant to Section 1350 of Chapter 63 of Title 18 of the U.S. Code
32e	Certification by Caroline Dorsa, pursuant to Section 1350 of Chapter 63 of Title 18 of the U.S. Code
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101.CAL	XBRL Taxonomy Calculation Linkbase
101.LAB	XBRL Taxonomy Extension Labels Linkbase
101.PRE	XBRL Taxonomy Extension Presentation Linkbase
101.DEF	XBRL Taxonomy Extension Definition Document

(1) Filed as Exhibit 3.1a with Quarterly Report on Form 10-Q for the quarter ended March 31, 2007, File No. 001-09120 on May 4, 2007 and incorporated herein by this reference.

(2) Filed as Exhibit 3.1 with Current Report on Form 8-K, File No. 001-09120 on November 18, 2009 and incorporated herein by this reference.
(3) Filed as Exhibit 3.1b with Quarterly Report on Form 10-Q for the quarter ended March 31, 2007, File No. 001-09120 on May 4, 2007 and incorporated herein by this reference.
(4) Filed as Exhibit 3.1c with Quarterly Report on Form 10-Q for the quarter ended March 31, 2007, File No. 001-09120 on May 4, 2007 and incorporated herein by this reference.
(5) Filed as Exhibit 4(f) with Quarterly Report on Form 10-Q for the quarter ended March 31, 1998, File No. 001-09120 on May 13, 1998 and incorporated herein by this reference.
(6) Filed as Exhibit 10.1 with Quarterly Report on Form 10-Q for the quarter ended September 30, 2011, File No. 001-09120 on November 1, 2011 and incorporated herein by this reference.
(7) Filed as Exhibit 10.2 with Quarterly Report on Form 10-Q for the quarter ended September 30, 2011, File No. 001-09120 on November 1, 2011 and incorporated herein by this reference.
(8) Filed as Exhibit 10a(4) with Annual Report on Form 10-K for the year ended December 31, 2007, File Nos. 001-09120 on February 28, 2008 and 000-49614, and incorporated herein by reference.
(9) Filed as Exhibit 10.5 with Quarterly Report on Form 10-Q for the quarter ended September 20, 2011, File No. 001-09120 on November 1, 2011 and incorporated herein by this reference.
(10) Filed with Registration Statement on Form S-8, File No. 333-106330 filed on June 20, 2003 and incorporated herein by this reference.
(11) Filed as Exhibit 10.6 with Quarterly Report on Form 10-Q for the quarter ended September 30, 2011, File No. 001-09120 on November 1, 2011 and incorporated herein by this reference.
(12) Filed as Exhibit 10 with Quarterly Report on Form 10-Q for the quarter ended September 30, 2011, File No. 001-09120 on November 1, 2011 and incorporated herein by this reference.
(13) Filed as Exhibit 10 with Quarterly Report on Form 10-Q for the quarter ended September 30, 2002, File No. 001-09120, on November 4, 2002 and incorporated herein by this reference.
(14) Filed as Exhibit 10a(7) with Annual Report on Form 10-K for the year ended December 31, 2000, File No. 001-09120, on March 6, 2001 and incorporated herein by this reference.
(15) Filed as Exhibit 10a(11) with Annual Report on Form 10-K for the year ended December 31, 2008, File No. 001-09120, on February 26, 2009 and incorporated herein by this reference.
(16) Filed as Exhibit 99 with Current Report on Form 8-K, File Nos. 001-09120, 000-49614 and 001-00973 on December 22, 2008 and incorporated herein by this reference.
(17) Filed as Exhibit 10a(14) with Annual Report on Form 10-K, for the year ended December 31, 2009, File No. 001-09120 on February 25, 2010 and incorporated herein by reference.
(18) Filed as Exhibit 10 with Quarterly Report on Form 10-Q, File No. 001-00973 on May 6, 2009 and incorporated herein by reference.
(19) Filed as Exhibit 10a(17) with Annual Report on Form 10-K for the year ended December 31, 2002, File No. 001-09120, on February 26, 2003 and incorporated herein by this reference.
(20) Filed as Exhibit 10a(20) with Annual Report on Form 10-K for the year ended December 31, 2002, File No. 001-09120, on February 26, 2003 and incorporated herein by this reference.
(21) Filed as Exhibit 10.1 with Quarterly Report on Form 10-Q for the quarter ended March 31, 2011, File No. 001-09120 on May 5, 2011 and incorporated herein by this reference.
(22) Filed as Exhibit 10.1 with Current Report on Form 8-K, File No. 001-09120 on February 19, 2009 and incorporated herein by reference.
(23) Filed as Exhibit 3.1 to Registration Statement on Form S-4, No. 333-69228 filed on September 10, 2001 and incorporated herein by this reference.
(24) Filed as Exhibit 3.2 to Registration Statement on Form S-4, No. 333-69228 filed on September 10, 2001 and incorporated herein by this reference.
(25) Filed as Exhibit 3.6 to Registration Statement on Form S-3, No. 333-105704 filed on May 30, 2003 and incorporated herein by this reference.
(26) Filed as Exhibit 3.7 to Registration Statement on Form S-3, No. 333-105704 filed on May 30, 2003 and incorporated herein by this reference.
(27) Filed as Exhibit 3.8 to Registration Statement on Form S-3, No. 333-105704 filed on May 30, 2003 and incorporated herein by this reference.
(28) Filed as Exhibit 3.9 to Registration Statement on Form S-3, No. 333-105704 filed on May 30, 2003 and incorporated herein by this reference.
(29) Filed as Exhibit 3.10 to Registration Statement on Form S-3, No. 333-105704 filed on May 30, 2003 and incorporated herein by this reference.
(30) Filed as Exhibit 4.1 to Registration Statement on Form S-4, No. 333-69228 filed on September 10, 2001 and incorporated herein by this reference.

(31) Filed as Exhibit 4.7 with Quarterly Report on Form 10-Q for the quarter ended March 31, 2002, File No. 000-49614, on May 15, 2002 and incorporated herein by this reference.
(32) Filed as Exhibit 3(a) with Quarterly Report on Form 10-Q for the quarter ended June 30, 1986, File No. 001-00973, on August 28, 1986 and incorporated herein by this reference.
(33) Filed as Exhibit 3a(2) with Annual Report on Form 10-K for the year ended December 31, 1987, File No. 001-00973, on March 28, 1988 and incorporated herein by this reference.
(34) Filed as Exhibit 3a(3) on Form 8-A, File No. 001-00973, on February 4, 1994 and incorporated herein by this reference.
(35) Filed as Exhibit 3a(4) on Form 8-A, File No. 001-00973, on February 4, 1994 and incorporated herein by this reference.
(36) Filed as Exhibit 3a(5) on Form 8-A, File No. 001-00973, on February 4, 1994 and incorporated herein by this reference.
(37) Filed as Exhibit 3.3 with Quarterly Report on Form 10-Q for the quarter ended March 31, 2007, File No. 001-00973 on May 4, 2007 and incorporated herein by this reference.
(38) Filed as Exhibit 4b(1) with Annual Report on Form 10-K for the year ended December 31, 1980, File No. 001-00973 on February 18, 1981 and incorporated herein by this reference.
(39) Filed as Exhibit 4b(2) with Annual Report on Form 10-K for the year ended December 31, 1980, File No. 001-00973 on February 18, 1981 and incorporated herein by this reference.
(40) Filed as Exhibit 4b(3) with Annual Report on Form 10-K for the year ended December 31, 1980, File No. 001-00973 on February 18, 1981 and incorporated herein by this reference.
(41) Filed as Exhibit 4b(4) with Annual Report on Form 10-K for the year ended December 31, 1980, File No. 001-00973 on February 18, 1981 and incorporated herein by this reference.
(42) Filed as Exhibit 4b(5) with Annual Report on Form 10-K for the year ended December 31, 1980, File No. 001-00973 on February 18, 1981 and incorporated herein by this reference.
(43) Filed as Exhibit 4b(6) with Annual Report on Form 10-K for the year ended December 31, 1980, File No. 001-00973 on February 18, 1981 and incorporated herein by this reference.
(44) Filed as Exhibit 4 on Form 8-A, File No. 001-00973 on June 1, 1991 and incorporated herein by this reference.
(45) Filed as Exhibit 4(i) on Form 8-A, File No. 001-00973 on December 1, 1993 and incorporated herein by this reference.
(46) Filed as Exhibit 4 on Form 8-A, File No. 001-00973 on December 1, 1993 and incorporated herein by this reference.
(47) Filed as Exhibit 4(i) on Form 8-A, File No. 001-00973 on February 4, 1994 and incorporated herein by this reference.
(48) Filed as Exhibit 4 on Form 8-A, File No. 001-00973 on March 15, 1994 and incorporated herein by this reference.
(49) Filed as Exhibit 4a(87) with Quarterly Report on Form 10-Q for the quarter ended September 30, 1994, File No. 001-00973 on November 8, 1994 and incorporated herein by this reference.
(50) Filed as Exhibit 4a(91) with Quarterly Report on Form 10-Q for the quarter ended September 30, 1994, File No. 001-00973, on November 8, 1994 and incorporated herein by this reference.
(51) Filed as Exhibit 4a(2) on Form 8-A, File No. 001-00973 on January 26, 1996 and incorporated herein by this reference.
(52) Filed as Exhibit 4a(3) on Form 8-A, File No. 001-00973 on January 26, 1996 and incorporated herein by this reference.
(53) Filed as Exhibit 4 on Form 8-A, File No. 001-00973 on May 15, 1998 and incorporated herein by this reference.
(54) Filed as Exhibit 4a(97) with Annual Report on Form 10-K for the year ended December 31, 2002, File No. 001-00973 on February 25, 2003 and incorporated herein by this reference.
(55) Filed as Exhibit 4a(98) with Annual Report on Form 10-K for the year ended December 31, 2003, File No. 001-00973 on February 25, 2004 and incorporated herein by this reference.
(56) Filed as Exhibit 4a(99) with Annual Report on Form 10-K for the year ended December 31, 2003, File No. 001-00973 on February 25, 2004 and incorporated herein by this reference.
(57) Filed as Exhibit 4a(100) with Annual Report on Form 10-K for the year ended December 31, 2003, File No. 001-00973 on February 25, 2004 and incorporated herein by this reference.
(58) Filed as Exhibit 4a(101) with Annual Report on Form 10-K for the year ended December 31, 2003, File No. 001-00973 on February 25, 2004 and incorporated herein by this reference.
(59) Filed as Exhibit 4a(102) with Annual Report on Form 10-K for the year ended December 31, 2003, File No. 001-00973 on February 25, 2004 and incorporated herein by this reference.
(60) Filed as Exhibit 4 with Quarterly Report on Form 10-Q for the quarter ended June 30, 2004, File No. 001-00973 on August 3, 2004 and incorporated herein by this reference.
(61) Filed as Exhibit 4a(25) with Annual Report on Form 10-K for the year ended December 31, 2004, File No. 001-00973 on March 1, 2005 and incorporated herein by this reference.
(62) Filed as Exhibit 4a(26) with Annual Report on Form 10-K for the year ended December 31, 2004, File No. 001-00973 on March 1, 2005 and incorporated herein by this reference.
(63) Filed as Exhibit 4a(27) with Annual Report on Form 10-K for the year ended December 31, 2004, File No. 001-00973 on March 1, 2005 and incorporated herein by this reference.
(64) Filed as Exhibit 4a(28) with Annual Report on Form 10-K for the year ended December 31, 2004, File No. 001-00973 on March 1, 2005 and incorporated herein by this reference.

(65) Filed as Exhibit 4a(28) with Annual Report on Form 10-K for the year ended December 31, 2007, File No. 001-00973, on February 28, 2008 and incorporated herein by this reference.
(66) Filed as Exhibit 4a(29) with Annual Report on Form 10-K, for the year ended December 31, 2009, File No. 001-00973 on February 25, 2010 and incorporated herein by reference.
(67) Filed as Exhibit 4a(30) with Annual Report on Form 10-K, for the year ended December 31, 2009, File No. 001-00973 on February 25, 2010 and incorporated herein by reference.
(68) Filed as Exhibit 4 with Quarterly Report on Form 10-Q for the quarter ended September 30, 2010, File No. 001-00973 on October 29, 2010 and incorporated herein by reference.
(69) Filed as Exhibit 4 with Current Report on Form 8-K, File No. 001-00973 on December 1, 1993 and incorporated herein by this reference.
(70) Filed as Exhibit 4.6 to Registration Statement on Form S-3, No. 333-76020 filed on December 27, 2001 and incorporated herein by this reference.
(71) Filed as Exhibit 10.2 with Current Report on Form 8-K, File No. 001-00973 on February 19, 2009 and incorporated herein by reference.
(72) Filed as Exhibit 10.2 with Quarterly Report on Form 10-Q for the quarter ended March 31, 2011, File No. 001-09120 on May 5, 2011 and incorporated herein by this reference.
(73) Filed as Exhibit 10.1 with Quarterly Report on Form 10-Q for the quarter ended June 30, 2011, File No. 001-09120 on August 3, 2011 and incorporated herein by this reference.
(74) Filed as Exhibit 10.2 with Quarterly Report on Form 10-Q for the quarter ended June 30, 2011, File No. 001-09120 on August 3, 2011 and incorporated herein by this reference.
(75) Filed as Exhibit 10a(7) with Annual Report on Form 10-K for the year ended December 31, 2011, File No. 001-09120 on February 27, 2012.
(76) Filed as Exhibit 10a(19) with Annual Report on Form 10-K for the year ended December 31, 2011, File No. 001-09120 on February 27, 2012.
(77) Filed as Exhibit 10a(20) with Annual Report on Form 10-K for the year ended December 31, 2011, File No. 001-09120 on February 27, 2012.
(78) Filed as Exhibit 10 with Current Report on Form 8-K, File No. 001-09120 on November 26, 2012 and incorporated herein by reference.

PUBLIC SERVICE ENTERPRISE GROUP INCORPORATED

Schedule II—Valuation and Qualifying Accounts Years Ended December 31, 2012—December 31, 2010

Column A	Column B	Column C		Column D		Column E
		Additions				
Description	Balance at Beginning of Period	Charged to cost and expenses	Charged to other accounts-describe	Deductions-describe		Balance at End of Period
			Millions			
2012						
Allowance for Doubtful Accounts	$ 56	$ 96	$ —	$ 96	(A)	$ 56
Materials and Supplies Valuation Reserve	3	21	—	2	(B)	22
2011						
Allowance for Doubtful Accounts	$ 68	$ 102	$ —	$ 114	(A)	$ 56
Materials and Supplies Valuation Reserve	4	2	—	3	(B)	3
2010						
Allowance for Doubtful Accounts	$ 79	$ 99	$ —	$ 110	(A)	$ 68
Materials and Supplies Valuation Reserve	5	—	—	1	(B)	4
Other Valuation Allowances	8	—	—	8	(C)	—

(A) Accounts Receivable written off.

(B) Reduced reserve to appropriate level and to remove obsolete inventory.

(C) Valuation Allowance written off.

PSEG POWER LLC

Schedule II—Valuation and Qualifying Accounts Years Ended December 31, 2012—December 31, 2010

Column A	Column B	Column C Additions		Column D		Column E
Description	Balance at Beginning of Period	Charged to cost and expenses	Charged to other accounts-describe	Deductions-describe		Balance at End of Period
			Millions			
2012						
Materials and Supplies Valuation Reserve	$ 3	$ 21	$ —	$ 2	(A)	$ 22
2011						
Materials and Supplies Valuation Reserve	$ 4	$ 2	$ —	$ 3	(A)	$ 3
2010						
Materials and Supplies Valuation Reserve	$ 5	$ —	$ —	$ 1	(A)	$ 4

(A) Reduced reserve to appropriate level and to remove obsolete inventory.

PUBLIC SERVICE ELECTRIC AND GAS COMPANY

Schedule II—Valuation and Qualifying Accounts Years Ended December 31, 2012—December 31, 2010

	Column A	Column B	Column C Additions		Column D		Column E
	Description	Balance at Beginning of Period	Charged to cost and expenses	Charged to other accounts-describe	Deductions-describe		Balance at End of Period
2012				Millions			
	Allowance for Doubtful Accounts	$ 56	$ 96	$ —	$ 96	(A)	$ 56
2011							
	Allowance for Doubtful Accounts	$ 67	$ 102	$ —	$ 113	(A)	$ 56
2010							
	Allowance for Doubtful Accounts	$ 78	$ 99	$ —	$ 110	(A)	$ 67

(A) Accounts Receivable written off.

GLOSSARY OF TERMS

When the following terms and abbreviations appear in the text of this report, they have the meanings indicated below:

Term	Phrase/Description
Base load	Minimum amount of electric power delivered or required over a given period of time at a constant rate, this is the level of demand that is seen as a minimum during a 24-hour day
BGS	Basic Generation Service
	PSE&G is required to provide BGS for all customers in New Jersey who are not supplied by a TPS.
BGS-Fixed Price	Basic Generation Service-Fixed Price
	Seasonally adjusted fixed prices charged for a three-year term for electric supply service to smaller industrial and commercial customers and residential customers who are not supplied by a TPS
BGSS	Basic Gas Supply Service
	Mechanism approved by the BPU for NJ utilities to recover all commodity costs related to supplying gas to residential customers
BPU	New Jersey Board of Public Utilities
	Agency responsible for regulating public utilities doing business in New Jersey
Capacity	Amount of electricity that can be produced by a specific generating facility
CAA	Clean Air Act
Combined Cycle	A method of generation whereby electricity and process steam are produced from otherwise lost waste heat exiting from one or more combustion turbines. The exiting heat is routed to a conventional boiler or to a heat recovery steam generator for use by a steam turbine in the production of electricity
Competition Act	Electric Discount and Energy Competition Act
	New Jersey's 1999 Electric Utility Restructuring Legislation
Congestion	Condition when the available capacity of a transmission line is being closely approached (or exceeded) by the electric power trying to go through it; at such times, alternative power line pathways (or local generators near the load) must be used instead
Distribution	The delivery of electricity to the retail customer's home, business or industrial facility through low voltage distribution lines
EDC	Electric Distribution Company
	A company that owns the power lines and equipment necessary to deliver purchased electricity to the end user.
Energy Holdings	PSEG Energy Holdings L.L.C.
EPA	U.S. Environmental Protection Agency
FASB	Financial Accounting Standards Board
	A private, not-for-profit organization whose primary purpose, as designated by the SEC, is to develop accounting standards for public companies in the U.S.
FERC	U.S. Federal Energy Regulatory Commission
Forward contracts	A customized, non-exchange traded contract in which the buyer is obligated to deliver a specified amount of a commodity with a predetermined price formula on a specified future date, at which time payment is due in full
GAAP	Generally Accepted Accounting Principles
	Standard framework of guidelines issued by the FASB for financial accounting used in the U.S.
GHG	Greenhouse gas emissions (including carbon dioxide, methane, nitrous oxide, ozone, and chlorofluorocarbon) that trap the heat of the sun in the earth's atmosphere, increasing the mean global surface temperature of the earth

Term	Phrase/Description
Grid	A system of interconnected power lines and generators that is managed so that the generators are dispatched as needed to meet the electricity requirements of the customers connected to the grid at various points
Hedging	Entering into a contract or transaction designed to reduce exposure to various risks, such as changes in market prices
Hope Creek	Hope Creek Nuclear Generating Station
ISO	Independent System Operator
	An independent, regulated entity established to manage a regional electric transmission system in a non-discriminatory manner and to help ensure the safety and reliability of the bulk of the power system
ITC	Investment Tax Credit
	A credit against income taxes, usually computed as a percent of the cost of investment in certain types of assets
LCAPP	Long-Term Capacity Agreement Pilot Program
	A program established in January 2011 which provides for up to 2,000 MW of subsidized base load or mid-merit electric power generation in New Jersey.
Lifeline Program	A New Jersey social program for utility assistance that offers $225 per year to persons who meet the eligibility requirements
Load	Amount of electric power delivered or required at any specific point or points on a system. The requirement originates at the energy-consuming equipment of consumers.
MBR	Market Based Rates
	Electric service prices determined in an open market system of supply and demand under which the price is set solely by agreement as to what a buyer will pay and a seller will accept
MGP	Manufactured Gas Plant
NDT	Nuclear Decommissioning Trust
ISO-NE	New England Power Pool
	An ISO comprised of an alliance of approximately 100 utility companies who manage and direct all major energy production and transmission in the New England states
NJDEP	New Jersey Department of Environmental Protection
NRC	U.S. Nuclear Regulatory Commission
NUG	Non-Utility Generation
	Power produced by independent power producers, exempt wholesale generators and other companies that have been exempted from traditional utility regulation
OPEB	Other Postretirement Benefits
	Benefits other than pensions payable to former employees
Outage	The period during which a generating unit, transmission line, or other facility is out of service due to scheduled (planned) or unscheduled maintenance
Peach Bottom	Peach Bottom Atomic Power Station

Term	Phrase/Description
PJM	PJM Interconnection, L.L.C.
	A regional transmission organization that coordinates the movement of wholesale electricity in all or parts of 13 northeastern states and the District of Columbia
Power	PSEG Power LLC
Power Pool	An association of two or more interconnected electric systems having an agreement to coordinate operations and planning for improved reliability and efficiencies
PRP	Potentially Responsible Parties
PSE&G	Public Service Electric and Gas Company
PSEG	Public Service Enterprise Group Incorporated
Renewable Energy	Energy derived from resources that are regenerative or that cannot be depleted (i.e. moving water (hydro, tidal and wave power), thermal gradients in ocean water, biomass, geothermal energy, solar energy, and wind energy)
Regulatory Asset	Costs deferred by a regulated utility company in accordance with SFAS 71
Regulatory Liability	Costs recognized by a regulated utility company in accordance with SFAS 71
RGGI	Regional Greenhouse Gas Initiative
	The first mandatory, market-based effort in the U. S. to reduce greenhouse gas emissions; states will sell emission allowances through auctions and invest proceeds in consumer benefits: energy efficiency, renewable energy, and other clean energy technologies
RMR	Reliability-Must-Run
	Designation of a power plant whose output is needed to maintain local reliability regardless of its operating cost or market price
RPM	Reliability Pricing Model
	A process for pricing generation capacity based on overall system reliability requirements; using multi-year forward auctions, participants could bid capacity in the form of generation, demand response, or transmission to meet reliability needs by location and/or an ISO market
Salem	Salem Nuclear Generating Station
SBC	Societal Benefits Charge
SEC	U.S. Securities and Exchange Commission
Services	PSEG Services Corporation
Spill Act	New Jersey Spill Compensation and Control Act
TPS	Third Party Supplier
Transmission	The high-voltage wires and networks that move electricity through states and regions in large quantities -- from power plants where it is produced, to the distribution networks that deliver it to homes and businesses.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized. The signature of the undersigned company shall be deemed to relate only to matters having reference to such company and any subsidiaries thereof.

PUBLIC SERVICE ENTERPRISE GROUP INCORPORATED

By: /s/ RALPH IZZO

Ralph Izzo
Chairman of the Board, President and
Chief Executive Officer

Date: February 25, 2013

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated. The signatures of the undersigned shall be deemed to relate only to matters having reference to such company and any subsidiaries thereof.

Signature	Title	Date
/s/ RALPH IZZO **Ralph Izzo**	Chairman of the Board, President, Chief Executive Officer and Director (Principal Executive Officer)	February 25, 2013
/s/ CAROLINE DORSA **Caroline Dorsa**	Executive Vice President and Chief Financial Officer (Principal Financial Officer)	February 25, 2013
/s/ DEREK M. DIRISIO **Derek M. DiRisio**	Vice President and Controller (Principal Accounting Officer)	February 25, 2013
/s/ ALBERT R. GAMPER, JR. **Albert R. Gamper, Jr.**	Director	February 25, 2013
/s/ WILLIAM V. HICKEY **William V. Hickey**	Director	February 25, 2013
/s/ SHIRLEY ANN JACKSON **Shirley Ann Jackson**	Director	February 25, 2013
/s/ DAVID LILLEY **David Lilley**	Director	February 25, 2013
/s/ THOMAS A. RENYI **Thomas A. Renyi**	Director	February 25, 2013
/s/ HAK CHEOL SHIN **Hak Cheol Shin**	Director	February 25, 2013
/s/ RICHARD J. SWIFT **Richard J. Swift**	Director	February 25, 2013
/s/ SUSAN TOMASKY **Susan Tomasky**	Director	February 25, 2013
/s/ ALFRED W. ZOLLAR **Alfred W. Zollar**	Director	February 25, 2013

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized. The signature of the undersigned company shall be deemed to relate only to matters having reference to such company and any subsidiaries thereof.

PSEG POWER LLC

By: /s/ WILLIAM LEVIS

William Levis
President and
Chief Operating Officer

Date: February 25, 2013

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated. The signatures of the undersigned shall be deemed to relate only to matters having reference to such company and any subsidiaries thereof.

Signature	Title	Date
/s/ RALPH IZZO **Ralph Izzo**	Chairman of the Board and Chief Executive Officer and Director (Principal Executive Officer)	February 25, 2013
/s/ CAROLINE DORSA **Caroline Dorsa**	Executive Vice President and Chief Financial Officer and Director (Principal Financial Officer)	February 25, 2013
/s/ DEREK M. DIRISIO **Derek M. DiRisio**	Vice President and Controller (Principal Accounting Officer)	February 25, 2013
/s/ J.A. BOUKNIGHT, JR. **J.A. Bouknight, Jr.**	Director	February 25, 2013
/s/ WILLIAM LEVIS **William Levis**	Director	February 25, 2013
/s/ RANDALL E. MEHRBERG **Randall E. Mehrberg**	Director	February 25, 2013
/s/ MARGARET M. PEGO **Margaret M. Pego**	Director	February 25, 2013

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized. The signature of the undersigned company shall be deemed to relate only to matters having reference to such company and any subsidiaries thereof.

PUBLIC SERVICE ELECTRIC AND GAS COMPANY

By: /s/ RALPH LAROSSA
Ralph LaRossa
President and Chief Operating Officer

Date: February 25, 2013

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated. The signatures of the undersigned shall be deemed to relate only to matters having reference to such company and any subsidiaries thereof.

Signature	Title	Date
/s/ RALPH IZZO **Ralph Izzo**	Chairman of the Board and Chief Executive Officer and Director (Principal Executive Officer)	February 25, 2013
/s/ CAROLINE DORSA **Caroline Dorsa**	Executive Vice President and Chief Financial Officer (Principal Financial Officer)	February 25, 2013
/s/ DEREK M. DIRISIO **Derek M. DiRisio**	Vice President and Controller (Principal Accounting Officer)	February 25, 2013
/s/ ALBERT R. GAMPER, JR. Albert R. Gamper Jr.	Director	February 25, 2013
/s/ SHIRLEY ANN JACKSON **Shirley Ann Jackson**	Director	February 25, 2013
/s/ RICHARD J. SWIFT **Richard J. Swift**	Director	February 25, 2013

EXHIBIT INDEX

The following documents are filed as a part of this report:

a. PSEG:	
Exhibit 10a(11):	Amended and Restated Key Executive Severance Plan, amended effective December 17, 2012
Exhibit 12:	Computation of Ratios of Earnings to Fixed Charges
Exhibit 21:	Subsidiaries of the Registrant
Exhibit 23:	Consent of Independent Registered Public Accounting Firm
Exhibit 31:	Certification by Ralph Izzo Pursuant to Rules 13a-14 and 15d-14 of the 1934 Act
Exhibit 31a:	Certification by Caroline Dorsa Pursuant to Rules 13a-14 and 15d-14 of the 1934 Act
Exhibit 32:	Certification by Ralph Izzo Pursuant to Section 1350 of Chapter 63 of Title 18 of the U.S. Code
Exhibit 32a:	Certification by Caroline Dorsa Pursuant to Section 1350 of Chapter 63 of Title 18 of the U.S. Code
Exhibit 101.INS:	XBRL Instance Document
Exhibit 101.SCH:	XBRL Taxonomy Extension Schema
Exhibit 101.CAL:	XBRL Taxonomy Calculation Linkbase
Exhibit 101.LAB:	XBRL Taxonomy Extension Labels Linkbase
Exhibit 101.PRE:	XBRL Taxonomy Extension Presentation Linkbase
Exhibit 101.DEF:	XBRL Taxonomy Extension Definition Document
b. Power:	
Exhibit 10a(9):	Amended and Restated Key Executive Severance Plan, amended effective December 17, 2012
Exhibit 12a:	Computation of Ratios of Earnings to Fixed Charges
Exhibit 23a:	Consent of Independent Registered Public Accounting Firm
Exhibit 31b:	Certification by Ralph Izzo Pursuant to Rules 13a-14 and 15d-14 of the 1934 Act
Exhibit 31c:	Certification by Caroline Dorsa Pursuant to Rules 13a-14 and 15d-14 of the 1934 Act
Exhibit 32b:	Certification by Ralph Izzo Pursuant to Section 1350 of Chapter 63 of Title 18 of the U.S. Code
Exhibit 32c:	Certification by Caroline Dorsa Pursuant to Section 1350 of Chapter 63 of Title 18 of the U.S. Code
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Exhibit 101.CAL:	XBRL Taxonomy Calculation Linkbase
Exhibit 101.LAB:	XBRL Taxonomy Extension Labels Linkbase
Exhibit 101.PRE:	XBRL Taxonomy Extension Presentation Linkbase
Exhibit 101.DEF:	XBRL Taxonomy Extension Definition Document
c. PSE&G:	
Exhibit 4a(32):	Supplemental Indenture to Mortgage Indenture, dated May 1, 2012

Exhibit 4a(33):	Supplemental Indenture to Mortgage Indenture, dated June 1, 2012
Exhibit 10a(10):	Amended and Restated Key Executive Severance Plan, amended effective December 17, 2012
Exhibit 12b:	Computation of Ratios of Earnings to Fixed Charges
Exhibit 12c:	Computation of Ratios of Earnings to Fixed Charges Plus Preferred Stock Dividend Requirements
Exhibit 23b:	Consent of Independent Registered Public Accounting Firm
Exhibit 31d:	Certification by Ralph Izzo Pursuant to Rules 13a-14 and 15d-14 of the 1934 Act
Exhibit 31e:	Certification by Caroline Dorsa Pursuant to Rules 13a-14 and 15d-14 of the 1934 Act
Exhibit 32d:	Certification by Ralph Izzo Pursuant to Section 1350 of Chapter 63 of Title 18 of the U.S. Code
Exhibit 32e:	Certification by Caroline Dorsa Pursuant to Section 1350 of Chapter 63 of Title 18 of the U.S. Code
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Exhibit 4a(32)

SUPPLEMENTAL MORTGAGE

Supplemental Indenture

Dated May 1, 2012

SUPPLEMENTAL TO
FIRST AND REFUNDING MORTGAGE
DATED AUGUST 1, 1924

PUBLIC SERVICE ELECTRIC AND GAS COMPANY
TO
U.S. BANK NATIONAL ASSOCIATION
Trustee
21 South Street
Morristown, New Jersey 07960

PROVIDING FOR THE ISSUE OF
$1,500,000,000 FIRST AND REFUNDING MORTGAGE BONDS,
MEDIUM-TERM NOTES SERIES H

RECORD IN MORTGAGE BOOK AND RETURN TO:
M. COURTNEY McCORMICK, ESQ.
80 PARK PLAZA, T5B
NEWARK, N.J. 07102-4194

Prepared by

(DONALD S. LEIBOWITZ, ESQ.)

TABLE OF CONTENTS

SUPPLEMENTAL INDENTURE, dated the 1st day of May 2012 for convenience of reference and effective from the time of execution and delivery hereof, between PUBLIC SERVICE ELECTRIC AND GAS COMPANY, a corporation organized under the laws of the State of New Jersey, hereinafter called the "Company", party of the first part, and U.S. Bank National Association, a national banking association organized under the laws of the United States of America, as successor Trustee to Wachovia Bank, National Association (previously known as Fidelity Union Trust Company) under the indenture dated August 1, 1924, below mentioned, hereinafter called the "Trustee", party of the second part.

WHEREAS, on July 25, 1924, the Company executed and delivered to FIDELITY UNION TRUST COMPANY, a certain indenture dated August 1, 1924 (hereinafter called the "Indenture") to secure and to provide for the issue of First and Refunding Mortgage Gold Bonds of the Company; and

WHEREAS, the Indenture has been recorded in the following counties of the State of New Jersey, in the offices, and therein in the books and at the pages, as follows:

County	Office	Book Number	Page Number
Atlantic	Clerk's	1955 of Mortgages	160
Bergen	Clerk's	94 of Chattel Mortgages	123 etc.
		693 of Mortgages	88 etc.
Burlington	Clerk's	52 of Chattel Mortgages	Folio 8 etc.
		177 of Mortgages	Folio 354 etc.
Camden	Register's	45 of Chattel Mortgages	184 etc.
		239 of Mortgages	1 etc.
Cumberland	Clerk's	786 of Mortgages	638 & c.
Essex	Register's	437 of Chattel Mortgages	1-48
		T-51 of Mortgages	341-392
Gloucester	Clerk's	34 of Chattel Mortgages	123 etc.
		142 of Mortgages	7 etc.
Hudson	Register's	453 of Chattel Mortgages	9 etc.
		1245 of Mortgages	484, etc.
Hunterdon	Clerk's	151 of Mortgages	344
Mercer	Clerk's	67 of Chattel Mortgages	1 etc.
		384 of Mortgages	1 etc.
Middlesex	Clerk's	113 of Chattel Mortgages	3 etc.
		437 of Mortgages	294 etc.
Monmouth	Clerk's	951 of Mortgages	291 & c.
Morris	Clerk's	N-3 of Chattel Mortgages	446 etc.
		F-10 of Mortgages	269 etc.
Ocean	Clerk's	1809 of Mortgages	40
Passaic	Register's	M-6 of Chattel Mortgages	178, etc.
		R-13 of Mortgages	268 etc.
Salem	Clerk's	267 of Mortgages	249 etc.
Somerset	Clerk's	46 of Chattel Mortgages	207 etc.
		N-10 of Mortgages	1 etc.
Sussex	Clerk's	123 of Mortgages	10 & c.
Union	Register's	9584 of Mortgages	259 etc.
Warren	Clerk's	124 of Mortgages	141 etc.

and

WHEREAS, the Indenture has also been recorded in the following counties of the Commonwealth of Pennsylvania, in the offices, and therein in the books and at the pages, as follows:

County	Office	Book Number	Page Number
Adams	Recorder's	22 of Mortgages	105
Armstrong	Recorder's	208 of Mortgages	381
Bedford	Recorder's	90 of Mortgages	917
Blair	Recorder's	671 of Mortgages	430
Cambria	Recorder's	407 of Mortgages	352
Cumberland	Recorder's	500 of Mortgages	136
Franklin	Recorder's	285 of Mortgages	373
Huntington	Recorder's	128 of Mortgages	47
Indiana	Recorder's	197 of Mortgages	281
Lancaster	Recorder's	984 of Mortgages	1
Montgomery	Recorder's	5053 of Mortgages	1,221
Westmoreland	Recorder's	1281 of Mortgages	198
York	Recorder's	31-V of Mortgages	446

and

WHEREAS, the Indenture granted, bargained, sold, aliened, remised, released, conveyed, confirmed, assigned, transferred and set over unto the Trustee certain property of the Company, more fully set forth and described in the Indenture, then owned or which might thereafter be acquired by the Company; and

WHEREAS, the Company, by various supplemental indentures, supplemental to the Indenture, the last of which was dated October 1, 2010, has granted, bargained, sold, aliened, remised, released, conveyed, confirmed, assigned, transferred and set over unto the Trustee certain property of the Company acquired by it after the execution and delivery of the Indenture; and

WHEREAS, since the execution and delivery of said supplemental indenture dated October 1, 2010, the Company has acquired property which, in accordance with the provisions of the Indenture, is subject to the lien thereof and the Company desires to confirm such lien; and

WHEREAS, the Indenture has been amended or supplemented from time to time; and

WHEREAS, it is provided in the Indenture that no bonds other than those of the 5-1/2% Series due 1959 therein authorized may be issued thereunder unless a supplemental indenture providing for the issue of such additional bonds shall have been executed and delivered by the Company to the Trustee; and

WHEREAS, the Company is making provisions for the issuance and sale of its Secured Medium-Term Notes, Series H (the “Series H Notes”), to be issued under an Indenture of Trust (the “Note Indenture”) dated as of July 1, 1993 between the Company and The Chase Manhattan Bank (National Association) as predecessor trustee (The Bank of New York Mellon, as successor trustee to the predecessor trustee), as Trustee (the “Note Trustee”); and

WHEREAS, such Note Indenture provides, among other things, for the pledge and delivery by the Company of a series of First and Refunding Mortgage Bonds of the Company to evidence the Company’s obligation to pay the principal and interest with respect to outstanding Series H Notes; and for such purpose and in order to service and secure payment of the principal and interest in respect of the Series H Notes, the Company desires to provide for the issue of $1,500,000,000 aggregate principal amount of bonds under the Indenture of a series to be designated as “First and Refunding Mortgage Bonds, Medium-Term Notes Series H” (hereinafter sometimes called “Bonds of the Medium-Term Notes Series H”); and

WHEREAS, the text of the Bonds of the Medium-Term Notes Series H and of the certificate of authentication to be borne by the Bonds of the Medium-Term Notes Series H shall be substantially of the following tenor:

(FORM OF BOND)

This Bond is not transferable except as provided in the Indenture and in the Indenture of Trust dated as of July 1, 1993 between the Company and The Chase Manhattan Bank (National Association) (The Bank of New York Mellon, successor trustee) as Trustee.

REGISTERED REGISTERED
NUMBER AMOUNT
R $1,500,000,000

PUBLIC SERVICE ELECTRIC AND GAS COMPANY
FIRST AND REFUNDING MORTGAGE BOND,
MEDIUM-TERM NOTES SERIES H

Public Service Electric and Gas Company (hereinafter called the "Company"), a corporation of the State of New Jersey, for value received, hereby promises to pay to The Bank of New York Mellon as successor trustee to The Chase Manhattan Bank (National Association)), under the Indenture of Trust dated as of July 1, 1993 between the Company and such trustee, or registered assigns, on the surrender hereof, the principal sum of One Billion Five Hundred Million Dollars, on May 1, 2047, and to pay interest thereon from the date hereof, at the rate of 10% per annum, and until payment of said principal sum, such interest to be payable May 1 and November 1 in each year; provided, however, that the Company shall receive certain credits against such obligations as set forth in the Supplemental Indenture dated May 1, 2012 referred to below.

Both the principal hereof and interest hereon shall be paid at the principal corporate trust office of U.S. Bank National Association in the City of Morristown, State of New Jersey, or (at the option of the registered owner) at the corporate trust office of any paying agent appointed by the Company, in such coin or currency of the United States of America as at the time of payment shall constitute legal tender for the payment of public and private debts; provided, however, that any such payments of principal and interest shall be subject to receipt of certain credits against such payment obligations as set forth in the Supplemental Indenture dated May 1, 2012 referred to below.

This Bond is one of the First and Refunding Mortgage Bonds of the Company issued and to be issued under and pursuant to, and all equally secured by, an indenture of mortgage or deed of trust dated August 1, 1924, as supplemented and amended by supplemental indentures thereto, including the Supplemental Indenture dated May 1, 2012, duly executed by the Company and U.S. Bank National Association as Trustee. This Bond is one of the Bonds of the Medium-Term Notes Series H, which series is limited to the aggregate principal amount of $1,500,000,000 and is issued pursuant to said Supplemental Indenture dated May 1, 2012. Reference is hereby made to said indenture and all supplements thereto for a specification of the principal amount of Bonds from time to time issuable thereunder, and for a description of the properties mortgaged and conveyed or assigned to said Trustee or its successors, the nature and extent of the security, and the rights of the holders of said Bonds and any coupons appurtenant thereto, and of the Trustee in respect of such security.

In and by said indenture, as amended and supplemented, it is provided that with the written approval of the Company and the Trustee, any of the provisions of said indenture may from time to time be eliminated or modified and other provisions may be added thereto provided the change does not alter the annual interest rate, redemption price or date, date of maturity or amount payable on maturity of any then outstanding Bond or conflict with the Trust Indenture Act of 1939 as then in effect, and provided the holders of 85% in principal amount of the Bonds secured by said indenture and then outstanding (including, if such change affects the Bonds of one or more series but less than all series then outstanding, a like percentage of the then outstanding Bonds of each series affected by such change, and excluding Bonds owned or controlled by the Company or by the parties owning at least 10% of the outstanding voting stock of the Company, as more fully specified in said indenture) consent in writing thereto, all as more fully set forth in said indenture, as amended and supplemented.

First and Refunding Mortgage Bonds issuable under said indenture are issuable in series, and the Bonds of any series may be for varying principal amounts and in the form of coupon bonds and of registered bonds without coupons, and the Bonds of any one series may differ from the Bonds of any other series as to date, maturity, interest rate and otherwise, all as in said indenture provided and set forth. The Bonds of the Medium-Term Notes Series H, in which this Bond is included, are designated “First and Refunding Mortgage Bonds, Medium-Term Notes Series H”.

In case of the happening of an event of default as specified in said indenture and said supplemental indenture dated March 1, 1942, the principal sum of the Bonds of this series may be declared or may become due and payable forthwith, in the manner and with the effect in said indenture provided.

The Bonds of this series are subject to redemption as provided in the Supplemental Indenture dated May 1, 2012.

This Bond is transferable, but only as provided in said indenture and the Indenture of Trust dated as of July 1, 1993 between the Company and The Chase Manhattan Bank (National Association) as predecessor trustee (The Bank of New York Mellon, as successor trustee to the predecessor trustee), as trustee, upon surrender hereof, by the registered owner in person or by attorney duly authorized in writing, at either of said offices where the principal hereof and interest hereon are payable; upon any such transfer a new fully registered Bond similar hereto will be issued to the transferee. This Bond may in like manner be exchanged for one or more new fully registered Bonds of the same series of other authorized denominations but of the same aggregate principal amount. No service charge shall be made for any such transfer or exchange, but the Company may require payment of a sum sufficient to cover any tax or other governmental charge that may be imposed in relation thereto. The Company and the Trustee hereunder and any paying agent may deem and treat the person in whose name this Bond is registered as the absolute owner hereof for the purpose of receiving payment of or on account of the principal hereof and the interest hereon and for all other purposes; and neither the Company nor the Trustee hereunder nor any paying agent shall be affected by any notice to the contrary.

The Bonds of this series are issuable only in fully registered form, in any denomination authorized by the Company.

No recourse under or upon any obligation, covenant or agreement contained in said indenture or in any indenture supplemental thereto, or in any Bond issued thereunder, or because of any indebtedness arising thereunder, shall be had against any incorporator, or against any past, present or future stockholder, officer, or director, as such, of the Company or of any successor corporation, either directly or through the Company or any successor corporation, under any rule of law, statute or constitutional provision or by the enforcement of any assessment or by any legal or equitable proceeding or otherwise, it being expressly agreed and understood that said indenture, any indenture supplemental thereto and the obligations issued thereunder, are solely corporate obligations, and that no personal liability whatever shall attach to, or be incurred by, such incorporators, stockholders, officers or directors, as such, of the Company, or of any successor corporation, or any of them, because of the incurring of the indebtedness thereby authorized, or under or by reason of any of the obligations, covenants or agreements contained in the indenture or in any indenture supplemental thereto or in any of the Bonds issued thereunder, or implied therefrom.

This Bond shall not be entitled to any security or benefit under said indenture, as amended and supplemented, and shall not become valid or obligatory for any purpose, until the certificate of authentication, hereon endorsed, shall have been signed by U.S. Bank National Association as Trustee, or by its successor in trust under said indenture.

IN WITNESS WHEREOF, the Company has caused this Bond to be duly executed by its proper officers under its corporate seal.

Dated

PUBLIC SERVICE ELECTRIC AND GAS COMPANY,

By. . . . .
(Vice) President

(Seal)

Attest:

. . . .
(Assistant) Secretary

(FORM OF CERTIFICATE OF AUTHENTICATION)
CERTIFICATE OF AUTHENTICATION

This Bond is one of the Bonds of the series designated therein which is described in the within-mentioned indenture and supplemental indenture dated May 1, 2012, as secured thereby.

U.S. BANK NATIONAL ASSOCIATION, TRUSTEE,

By. . . . .
. . . .

Authorized Signatory

WHEREAS, the execution and delivery of this supplemental indenture have been duly authorized by the Board of Directors of the Company; and

WHEREAS, the Company represents that all things necessary to make the bond of the series hereinafter described, when duly authenticated by the Trustee and issued by the Company, a valid, and legal obligation of the Company, and to make this supplemental indenture a valid and binding agreement supplemental to the Indenture, have been done and performed:

NOW, THEREFORE, THIS SUPPLEMENTAL INDENTURE WITNESSETH that the Company, in consideration of the premises and the execution and delivery by the Trustee of this supplemental indenture, and in pursuance of the covenants and agreements contained in the Indenture and for other good and valuable consideration, the receipt of which is hereby acknowledged, has granted, bargained, sold, aliened, remised, released, conveyed, confirmed, assigned, transferred and set over, and by these presents does grant, bargain, sell, alien, remise, release, convey, confirm, assign, transfer and set over unto the Trustee, its successors and assigns, forever, all the right, title and interest of the Company in and to all property of every kind and description (except cash, accounts and bills receivable and all merchandise bought, sold or manufactured for sale in the ordinary course of the Company's business, stocks, bonds or other corporate obligations or securities, other than such as are described in Part V of the Granting Clauses of the Indenture, not acquired with the proceeds of bonds secured by the Indenture, and except as in the Indenture and herein otherwise expressly excluded) acquired by the Company since the execution and delivery of the supplemental indenture dated October 1, 2010, subsequent to the Indenture (except any such property duly released from, or disposed of, free from the lien of the Indenture, in accordance with the provisions thereof) and all such property which at any time hereafter may be acquired by the Company;

All of which property it is intended shall be included in and granted by this supplemental indenture and covered by the lien of the Indenture as heretofore and hereby amended and supplemented;

UNDER AND SUBJECT to any encumbrances or mortgages existing on property acquired by the Company at the time of such acquisition and not heretofore discharged of record; and

SUBJECT also, to the exceptions, reservations and provisions in the Indenture and in this supplemental indenture recited, and to the liens, reservations, exceptions, limitations, conditions and restrictions imposed by or contained in the several deeds, grants, franchises and contracts or other instruments through which the Company acquired or claims title to the aforesaid property; and Subject, also, to the existing leases, to liens on easements or rights of way, to liens for taxes, assessments and governmental charges not in default or the payment of which is deferred, pending appeal or other contest by legal proceedings, pursuant to Section 4 of Article Five of the indenture, or the payment of which is deferred pending billing, transfer of title or final determination of amount, to easements for alleys, streets, highways, rights of way and railroads that may run across or encroach upon the said property, to joint pole and similar agreements, to undetermined liens and charges, if any, incidental to construction, and other encumbrances permitted by the indenture as heretofore and hereby amended and supplemented;

TO HAVE AND TO HOLD the property hereby conveyed or assigned, or intended to be conveyed or assigned, unto the Trustee, its successor or successors and assigns, forever;

IN TRUST, NEVERTHELESS, upon the terms, conditions and trusts set forth in the Indenture as heretofore and hereby amended and supplemented, to the end that the said property shall be subject to the lien of the Indenture as heretofore and hereby amended and supplemented, with the same force and effect as though said property had been included in the Granting Clauses of the Indenture at the time of the execution and delivery thereof;

AND THIS SUPPLEMENTAL INDENTURE FURTHER WITNESSETH that for the considerations aforesaid, it is hereby covenanted between the Company and the Trustee as follows:

ARTICLE I.

BONDS OF THE MEDIUM-TERM NOTES SERIES H.

The series of bonds authorized by this supplemental indenture to be issued under and secured by the Indenture shall be designated "First and Refunding Mortgage Bonds, Medium-Term Notes Series H"; shall be limited to the aggregate principal amount of $1,500,000,000; shall be issued initially to the Note Trustee and shall mature and bear interest as set forth in the form of bond set forth herein; provided, however, that the Company shall receive certain credits against principal and interest as set forth in Section 3.01 hereof. The date of each Bond of the Medium-Term Notes Series H shall be the interest payment date next preceding the date of authentication, unless such date of authentication be an interest payment date, in which case the date shall be the date of authentication, or unless such date of authentication be prior to the first semi-annual interest payment date, in which case the date shall be May 1, 2012.

Bonds of the Medium-Term Notes Series H shall be issuable only in the form of fully registered bonds in any denomination authorized by the Company. Interest on the Bonds of the Medium-Term Notes Series H shall be payable semi-annually in arrears on May 1 and November 1 of each year, payable initially on November 1, 2012, subject to receipt of certain credits against principal and interest as set forth in Section 3.01 hereof and shall be payable as to both principal and interest in such coin or currency of the United States of America as at the time of payment shall constitute legal tender for the payment of public and private debts, at the principal corporate trust office of the Trustee, or at the corporate trust office of any paying agent appointed.

Bonds of the Medium-Term Notes Series H shall be transferable and exchangeable, but only as provided in the Indenture and the Note Indenture, upon surrender thereof for cancellation by the registered owner in person or by attorney duly authorized in writing at either of said offices. The Company hereby waives any right to make a charge for any transfer or exchange of Bonds of the Medium-Term Notes Series H, but the Company may require payment of a sum sufficient to cover any tax or any other governmental charge that may be imposed in relation thereto.

ARTICLE II.

REDEMPTION OF BONDS OF MEDIUM-TERM NOTES SERIES H.

SECTION 2.01. *Redemption—Redemption Price*. Bonds of the Medium-Term Notes Series H shall be subject to redemption prior to maturity under the conditions, and upon payment of the amounts as may be specified in the following conditions:

(a) at any time in whole or in part at the option of the Company upon receipt by the Trustee of written certification of the Company and of the Note Trustee that the principal amount of the Series H Notes then outstanding under the Note Indenture is not in excess of such principal amount of the Bonds of the Medium-Term Notes Series H as shall remain pledged to the Note Trustee after giving effect to such redemption; (b) at any time by the application of any proceeds of released property or other money held by the Trustee and which, pursuant to Section 4C of Article Eight of the Indenture, as amended and supplemented, are applied to the redemption of Bonds of the Medium-Term Notes Series H, upon payment of 100% of the principal amount thereof, together with interest accrued to the redemption date, provided that any such payment shall be subject to receipt by the Company of certain credits against such obligations as set forth in Section 3.01 hereof or (c) automatically upon failure to pay the principal of any Series H Notes then outstanding under the Note Indenture when due, on their stated maturity date or earlier redemption or repayment date, in a principal amount of Bonds of the Medium-Term Notes Series H equal to the principal amount of such Series H Notes, in each case, at a price equal to 100% of the principal amount thereof, together with accrued interest, if applicable.

SECTION 2.02. *Redemptions Pursuant to Section 4C of Article Eight of the Indenture*. If, pursuant to Section 4C of Article Eight of the Indenture, as amended and supplemented, any proceeds of released property or other money then held by the Trustee shall be applied to the redemption of the Bonds of the Medium-Term Notes Series H, the Trustee shall give at least 45 days prior written notice of such redemption to the Note Trustee whereupon on the date fixed for redemption such principal amount thereof as is equal to such proceeds shall be redeemed; provided that no such redemption shall be made unless the Trustee shall be in receipt of a written certification of the Company and the Note Trustee that a like principal amount of Series H Notes shall have been theretofore redeemed in accordance with the provisions of the Note Indenture. For purposes of determining which of the Company's First and Refunding Mortgage Bonds are subject to such mandatory redemption, the Mortgage Trustee shall consider the 10% stated annual interest rate of the Bonds of the Medium-Term Notes Series H, not the weighted average interest rate of outstanding Series H Notes. Bonds of said series so redeemed shall be cancelled.

SECTION 2.03. *Interest on Called Bonds to Cease.* Each Bond of the Medium-Term Notes Series H or portion thereof called for redemption under Section 2.02 hereof shall be due and payable at the office of the Note Trustee, as paying agent hereunder, at its redemption price and on the specified redemption date, anything herein or in such Bond to the contrary notwithstanding. From and after the date when each Bond of the Medium-Term Notes Series H or portion thereof shall be due and payable as aforesaid (unless upon said date the full amount due thereon shall not be held by the Note Trustee, as paying agent hereunder, and be immediately available for payment), all further interest shall cease to accrue on such bond or on such portion thereof, as the case may be.

SECTION 2.04. *Bonds Called in Part.* If only a portion of any Bond of the Medium-Term Notes Series H shall be called for redemption pursuant to Section 2.02 hereof, upon payment of the portion so called for redemption, the Note Trustee shall make an appropriate notation upon the Bond of the principal amount so redeemed.

SECTION 2.05. *Provisions of Indenture Not Applicable*. The provisions of Article Four of the Indenture, as amended and supplemented, shall not apply to the procedure for the exercise of any right of redemption reserved by the Company, or to any mandatory redemption provided, in this Article in respect of the Bonds of the Medium-Term Notes Series H. There shall be no sinking fund for the Bonds of the Medium-Term Notes Series H.

ARTICLE III.

CREDITS WITH RESPECT TO BONDS OF THE MEDIUM-TERM NOTES SERIES H.

SECTION 3.01. *Credits.* In addition to any other credit, payment or satisfaction to which the Company is entitled with respect to the Bonds of the Medium-Term Notes Series H, the Company shall be entitled to credits against amounts otherwise payable in respect of the Bonds of the Medium-Term Notes Series H in an amount corresponding to (i) the principal amount of any of the Company's Series H Notes issued under the Note Indenture surrendered to the Note Trustee by the Company, or purchased by the Note Trustee, for cancellation, (ii) the amount of money held by the Note Trustee and available and designated for the payment of principal or redemption price (exclusive of any premium) of, and/or interest on, the Series H Notes, regardless of the source of payment to the Note Trustee of such moneys and (iii) the amount by which principal of and interest due on the Bonds of the Medium-Term Notes Series H exceeds principal of and interest due on the Series H Notes. The Note Trustee shall make notation on such Bonds authorized hereby of any such credit.

SECTION 3.02. *Certificate of the Company.* A certificate of the Company signed by the President or any Vice President, and attested to by the Secretary or any Assistant Secretary, and consented to by the Note Trustee, stating that the Company is entitled to a credit under Section 3.01 hereof or that Bonds of the Medium-Term Notes Series H have been cancelled, and setting forth the basis therefor in reasonable detail, shall be conclusive evidence of such entitlement, and the Trustee shall accept such certificate as such evidence without further investigation or verification of the matters stated therein.

ARTICLE IV.

MISCELLANEOUS.

SECTION 4.01. *Authentication of Bonds of Medium-Term Notes Series H.* None of the Bonds of the Medium-Term Notes Series H, the issue of which is provided for by this supplemental indenture, shall be authenticated by or on behalf of the Trustee except in accordance with the provisions of the Indenture, as amended and supplemented, and this supplemental indenture, and upon compliance with the conditions in that behalf therein contained.

SECTION 4.02. *Additional Restrictions on Authentication of Additional Bonds Under Indenture.* The Company covenants that from and after the date of execution of this supplemental indenture no additional bonds (as defined in Section 1 of Article Two of the Indenture) shall be authenticated and delivered by the

Trustee under Subdivision A of Section 4 of said Article Two on account of additions or improvements to the mortgaged property;

(1) unless the net earnings of the Company for the period required by Subdivision C of Section 6 of said Article Two shall have been at least twice the fixed charges (in lieu of 1-3/4 times such fixed charges, as required by said Subdivision C); and for the purpose of this condition (a) such fixed charges shall in each case include interest on the bonds applied for, notwithstanding the parenthetical provision contained in clause (4) of said Subdivision C, and (b) in computing such net earnings there shall be included in expenses of operation (under paragraph (c) of said Subdivision C) all charges against earnings for depreciation, renewals or replacements, and all certificates with respect to net earnings delivered to the Trustee in connection with any authentication of additional bonds under said Article Two shall so state; and (2) except to the extent of 60% (in lieu of 75% as permitted by Subdivision A of Section 7 of said Article Two) of the cost or fair value to the Company of the additions or improvements forming the basis for such authentication of additional bonds.

SECTION 4.03. *Restriction on Dividends.* The Company will not declare or pay any dividend on any shares of its common stock (other than dividends payable in shares of its common stock) or make any other distribution on any such shares, or purchase or otherwise acquire any such shares (except shares acquired without cost to the Company) whenever such action would reduce the earned surplus of the Company to an amount less than $10,000,000 or such lesser amount as may remain after deducting from said $10,000,000 all amounts appearing in the books of account of the Company on December 31, 1948, which shall thereafter, pursuant to any order or rule of any regulatory body entered after said date, be required to be removed, in whole or in part, from the books of account of the Company by charges to earned surplus.

SECTION 4.04. *Use of Facsimile Seal and Signatures.* The seal of the Company and any or all signatures of the officers of the Company upon any of the Bonds of the Medium-Term Notes Series H may be facsimiles.

SECTION 4.05. *Time for Making of Payment.* All payments of principal or redemption price of, and interest on, the Bonds of the Medium-Term Notes Series H shall be made either prior to the due date thereof or on the due date thereof in immediately available funds. In any case where the date of any such payment shall be a Saturday or Sunday or a legal holiday or a day on which banking institutions in the city of payment are authorized by law to close, then such payment need not be made on such date but may be made on the next succeeding business day with the same force and effect as if made on the due date, and no interest on such payment shall accrue for the period after such date.

SECTION 4.06. *Effective Period of Supplemental Indenture.* The preceding provisions of Articles I, II and III of this supplemental indenture shall remain in effect only so long as any of the Bonds of the Medium-Term Notes Series H shall remain outstanding.

SECTION 4.07. *Effect of Approval of Board of Public Utilities of the State of New Jersey.* The approval of the Board of Public Utilities of the State of New Jersey of the execution and delivery of these presents and of the issue of any Bond of the Medium-Term Notes Series H shall not be construed as approval of said Board of any other act, matter or thing which requires approval of said Board under the laws of the State of New Jersey.

SECTION 4.08. *Execution in Counterparts.* For the purpose of facilitating the recording hereof, this supplemental indenture has been executed in several counterparts, each of which shall be and shall be taken to be an original, and all collectively but one instrument.

IN WITNESS WHEREOF, Public Service Electric and Gas Company, party hereto of the first part, after due corporate and other proceedings, has caused this supplemental indenture to be signed and acknowledged or proved by its President or one of its Vice Presidents and its corporate seal hereunto to be affixed and to be attested by the signature of its Secretary or an Assistant Secretary; and U.S. Bank National Association, as Trustee, party hereto of the second part, has caused this supplemental indenture to be signed and acknowledged or proved by its President or one of its Vice Presidents, and its corporate seal to be hereunto affixed and to be attested by the signature of its Secretary, Assistant Secretary, Vice President, or an Assistant Vice President. Executed and delivered this 4th day of May 2012.

Attest:

PUBLIC SERVICE ELECTRIC AND GAS COMPANY

By /s/ B.D. Huntington
. . . .
B.D. Huntington
Vice President

Attest:
/s/ M.C. McCormick
. . . .
M.C. McCormick
Secretary

U.S. BANK NATIONAL ASSOCIATION

By /s/ N. Barnes
. . . .
N. Barnes
Vice President

Attest:
/s/ T.J. Brett
. . . .
T.J. Brett
Vice President

STATE OF NEW JERSEY)

SS:)
COUNTY OF ESSEX)

Be it Remembered, that on this 4th day of May, 2012, before me, the subscriber, a Notary Public of the State of New Jersey, personally appeared B.D. Huntington, who, I am satisfied, is a Vice President of Public Service Electric and Gas Company, one of the corporations named in and which executed the foregoing instrument, and is the person who signed the said instrument as such officer, for and on behalf of such corporation, and I having first made known to him the contents thereof, he did acknowledge that he signed the said instrument as such officer, that the said instrument was made by such corporation and sealed with its corporate seal, that the said instrument is the voluntary act and deed of such corporation, made by virtue of authority from its Board of Directors, and that said corporation, the mortgagor, has received a true copy of said instrument.

/s/ Susan M. Costello
. . . .
Susan M. Costello
Notary Public of New Jersey
My Commission Expires March 26, 2017

STATE OF NEW JERSEY)

SS:)
COUNTY OF ESSEX)

Be it Remembered, that on this 4th day of May 2012 before me, the subscriber, a Notary Public of the State of New Jersey, personally appeared N. Barnes, who, I am satisfied, is a Vice President of U.S. Bank National Association, one of the corporations named in and which executed the foregoing instrument, and is the person who signed the said instrument as such officer, for and on behalf of such corporation, and I having first made known to him the contents thereof, he did acknowledge that he signed the said instrument as such officer, that the said instrument was made by such corporation and sealed with its corporate seal, and that the said instrument is the voluntary act and deed of such corporation, made by virtue of authority from its Board of Directors.

/s/ Melody A. Simpson
....
Melody A. Simpson
Notary Public of New Jersey
My Commission Expires March 1, 2016

CERTIFICATE OF RESIDENCE

U.S. Bank National Association, Mortgagee and Trustee within named, hereby certifies that its precise residence is 21 South Street, Morristown, New Jersey 07960.

U.S. BANK NATIONAL ASSOCIATION

By /s/ N. Barnes
. . . .
N. Barnes
Vice President

Exhibit 4a(33)

SUPPLEMENTAL MORTGAGE

Supplemental Indenture

Dated June 1, 2012

SUPPLEMENTAL TO
FIRST AND REFUNDING MORTGAGE
DATED AUGUST 1, 1924

PUBLIC SERVICE ELECTRIC AND GAS COMPANY
TO
U.S. BANK NATIONAL ASSOCIATION
Trustee
21 South Street
Morristown, New Jersey 07960

PROVIDING FOR THE ISSUE OF
FIRST AND REFUNDING MORTGAGE BONDS,
POLLUTION CONTROL SERIES AG

RECORD IN MORTGAGE BOOK AND RETURN TO:
M. COURTNEY McCORMICK, ESQ.
80 PARK PLAZA, T5B
P.O. BOX 570
NEWARK, N.J. 07101

This instrument prepared by
(EDWARD C. FEDAK, ESQ.)

TABLE OF CONTENTS

SUPPLEMENTAL INDENTURE, dated the 1st day of June, 2012, for convenience of reference and effective from the time of execution and delivery hereof, between PUBLIC SERVICE ELECTRIC AND GAS COMPANY, a corporation organized under the laws of the State of New Jersey, hereinafter called the “Company”, party of the first part, and U.S. BANK NATIONAL ASSOCIATION, a national banking association organized under the laws of the United States of America, as successor Trustee under the indenture dated August 1, 1924, below mentioned, hereinafter called the “Trustee”, party of the second part.

WHEREAS, on July 25, 1924, the Company executed and delivered to Fidelity Union Trust Company (U S. Bank National Association, successor trustee), a certain indenture dated August 1, 1924 (hereinafter called the “Indenture”), to secure and to provide for the issue of First and Refunding Mortgage Gold Bonds of the Company; and

WHEREAS, the Indenture has been recorded in the following counties of the State of New Jersey, in the offices, and therein in the books and at the pages, as follows:

County	Office	Book Number	Page Number
Atlantic	Clerk's	1955 of Mortgages	160
Bergen	Clerk's	94 of Chattel Mortgages	123 etc.
		693 of Mortgages	88 etc.
Burlington	Clerk's	52 of Chattel Mortgages	Folio 8 etc.
		177 of Mortgages	Folio 354 etc.
Camden	Register's	45 of Chattel Mortgages	184 etc.
		239 of Mortgages	1 etc.
Cumberland	Clerk's	786 of Mortgages	638 & c.
Essex	Register's	437 of Chattel Mortgages	1-48
		T-51 of Mortgages	341-392
Gloucester	Clerk's	34 of Chattel Mortgages	123 etc.
		142 of Mortgages	7 etc.
Hudson	Register's	453 of Chattel Mortgages	9 etc.
		1245 of Mortgages	484, etc.
Hunterdon	Clerk's	151 of Mortgages	344
Mercer	Clerk's	67 of Chattel Mortgages	1 etc.
		384 of Mortgages	1 etc.
Middlesex	Clerk's	113 of Chattel Mortgages	3 etc.
		437 of Mortgages	294 etc.
Monmouth	Clerk's	951 of Mortgages	291 & c.
Morris	Clerk's	N-3 of Chattel Mortgages	446 etc.
		F-10 of Mortgages	269 etc.
Ocean	Clerk's	1809 of Mortgages	40
Passaic	Register's	M-6 of Chattel Mortgages	178, etc.
		R-13 of Mortgages	268 etc.
Salem	Clerk's	267 of Mortgages	249 etc.
Somerset	Clerk's	46 of Chattel Mortgages	207 etc.
		N-10 of Mortgages	1 etc.
Sussex	Clerk's	123 of Mortgages	10 & c.
Union	Register's	9584 of Mortgages	259 etc.
Warren	Clerk's	124 of Mortgages	141 etc.

and

WHEREAS, the Indenture has also been recorded in the following counties of the Commonwealth of Pennsylvania, in the offices, and therein in the books and at the pages, as follows:

County	Office	Book Number	Page Number
Adams	Recorder's	22 of Mortgages	105
Armstrong	Recorder's	208 of Mortgages	381
Bedford	Recorder's	90 of Mortgages	917
Blair	Recorder's	671 of Mortgages	430
Cambria	Recorder's	407 of Mortgages	352
Cumberland	Recorder's	500 of Mortgages	136
Franklin	Recorder's	285 of Mortgages	373
Huntington	Recorder's	128 of Mortgages	47
Indiana	Recorder's	197 of Mortgages	281
Lancaster	Recorder's	984 of Mortgages	1
Montgomery	Recorder's	5053 of Mortgages	1,221
Westmoreland	Recorder's	1281 of Mortgages	198
York	Recorder's	31-V of Mortgages	446

and

WHEREAS, the Indenture granted, bargained, sold, aliened, remised, released, conveyed, confirmed, assigned, transferred and set over unto the Trustee certain property of the Company, more fully set forth and described in the Indenture, then owned or which might thereafter be acquired by the Company; and

WHEREAS, the Company, by various supplemental indentures, supplemental to the Indenture, the last of which was dated May 1, 2012, has granted, bargained, sold, aliened, remised, released, conveyed, confirmed, assigned, transferred and set over unto the Trustee certain property of the Company acquired by it after the execution and delivery of the Indenture; and

WHEREAS, since the execution and delivery of said supplemental indenture dated May 1, 2012, the Company has acquired property which, in accordance with the provisions of the Indenture, is subject to the lien thereof and the Company desires to confirm such lien; and

WHEREAS, the Indenture has been amended or supplemented from time to time; and

WHEREAS, it is provided in the Indenture that no bonds other than those of the 5 1/2% Series due 1959 therein authorized may be issued thereunder unless a supplemental indenture providing for the issue of such additional bonds shall have been executed and delivered by the Company to the Trustee; and

WHEREAS, The Pollution Control Financing Authority of Salem County (the "Authority") has previously issued and sold $50,000,000 aggregate principal amount of its Pollution Control Revenue Bonds, 1994 Series A (Public Service Electric and Gas Company Project) (the "1994 Authority Bonds") to finance the acquisition and construction by the Company of certain pollution control facilities at the Hope Creek Generating Station located in Lower Alloways Creek Township, Salem County, New Jersey (such generating station being sometimes referred to herein as the "Plant" and the pollution control facilities being sometimes referred to herein as the "Project"); and

WHEREAS, the ownership and operation of the Plant and the Project has been transferred by the Company to its affiliate, PSEG Nuclear LLC ("PSEG Nuclear"); and

WHEREAS, the Authority is making provision for the issuance and sale of its Pollution Control Revenue Refunding Bonds, 2012 Series A (Public Service Electric and Gas Company Project) (the "2012 Authority Bonds") to provide a portion of the funds for the refunding and redemption of the 1994 Authority Bonds; and

WHEREAS, the 2012 Authority Bonds are to be issued under a Trust Indenture to be dated as of June 1, 2012 (the "Authority Indenture") between the Authority and U.S. Bank National Association, as trustee (the "Authority Trustee"); and

WHEREAS, the Company will enter into a Pollution Control Facilities Loan Agreement dated as of June 1, 2012 (the "Agreement") with the Authority providing, among other things, for the loan by the Authority to the Company of funds to provide a portion of the funds for the refunding and redemption of the 1994 Authority Bonds, and for the issuance by the Company to the Authority Trustee, as assignee of the Authority, of First and Refunding Mortgage Bonds of the Company to evidence the Company's obligation to repay said loan, and for such purposes the Company desires to provide for the issue of $50,000,000 aggregate principal amount of bonds secured by the Indenture of a series to be designated as "First and Refunding Mortgage Bonds, Pollution Control Series AG" (hereinafter sometimes called "Pollution Control Series AG"); and

WHEREAS, the text of the bonds of the Pollution Control Series AG and of the certificate of authentication to be borne by the bonds of the Pollution Control Series AG shall be substantially of the following tenor:

[FORM OF BOND]

This Bond is not transferable except as provided in the Trust Indenture dated as of June 1, 2012 between The Pollution Control Financing Authority of Salem County and U.S. Bank National Association, as Trustee (the "Authority Indenture"). Capitalized terms used herein, not otherwise expressly defined herein, shall have the meanings ascribed to them in the Authority Indenture.

REGISTERED NUMBER **REGISTERED AMOUNT**
R- **$50,000,000**

PUBLIC SERVICE ELECTRIC AND GAS COMPANY
FIRST AND REFUNDING MORTGAGE BOND,
POLLUTION CONTROL SERIES AG

Public Service Electric and Gas Company (hereinafter called the "Company"), a corporation of the State of New Jersey, for value received, hereby promises to pay to U.S. Bank National Association, as trustee under the Authority Indenture, or registered assigns, the principal sum of Fifty Million Dollars, on April 1, 2046, and to pay interest thereon from the date hereof, at the rate of 15.0% per annum, and until payment of said principal sum, provided, however, that the Company shall receive certain credits against such obligations to the extent that interest payable by the Authority from time to time for the Authority's Pollution Control Revenue Refunding Bonds, 2012 Series A (Public Service Electric and Gas Company Project) (the "2012 Authority Bonds") issued pursuant to the Authority Indenture is less than interest calculated pursuant to the foregoing rate. Such interest to be payable at such times and in such manner as interest is payable on the 2012 Authority Bonds.

Both the principal hereof and interest hereon shall be paid at the corporate trust office of U.S. Bank National Association in the City of Morristown, State of New Jersey, or at the corporate trust office of any paying agent appointed by the Company, in such coin or currency of the United States of America as at the time of payment shall constitute legal tender for the payment of public and private debts.

This Bond is one of the First and Refunding Mortgage Bonds of the Company issued and to be issued under and pursuant to, and all equally secured by, an indenture of mortgage or deed of trust dated August 1, 1924, between the Company and U.S. Bank National Association, a national banking association, as successor Trustee, as supplemented and amended by the supplemental indentures thereto, including the supplemental indenture dated June 1, 2012. This Bond is one of the Bonds of the Pollution Control Series AG, which series is limited to the aggregate principal amount of $50,000,000 and is issued pursuant to said supplemental indenture dated June 1, 2012. Reference is hereby made to said indenture and all supplements thereto for a specification of the principal amount of Bonds from time to time issuable thereunder, and for a description of the properties mortgaged and conveyed or assigned to said Trustee or its successors, the nature and extent of the security, and the rights of the holders of said Bonds and any coupons appurtenant thereto, and of the Trustee in respect of such security.

In and by said indenture, as amended and supplemented, it is provided that with the written approval of the Company and the Trustee, any of the provisions of said indenture may from time to time be eliminated or modified and other provisions may be added thereto provided the change does not alter the annual interest rate, interest payment dates, redemption price or date, date of maturity or amount payable on maturity of any then outstanding Bond or conflict with the Trust Indenture Act of 1939 as then in effect, and provided the holders of 85% in principal amount of the Bonds secured by said indenture and then outstanding (including, if such change affects the Bonds of one or more series but less than all series then outstanding, a like percentage of the then outstanding Bonds of each series affected by such change, and excluding Bonds owned or controlled by the Company or by the parties owning at least 10% of the outstanding voting stock of the Company, as more fully specified in said indenture) consent in writing thereto, all as more fully set forth in said indenture, as amended and supplemented.

First and Refunding Mortgage Bonds issuable under said indenture are issuable in series, and the Bonds of any series may be for varying principal amounts and in the form of coupon Bonds and of registered Bonds without coupons, and the Bonds of any one series may differ from the Bonds of any other series as to date, maturity, interest rate and otherwise, all as in said indenture provided and set forth. The Bonds of the Pollution Control Series AG, in which this Bond is included, are designated "First and Refunding Mortgage Bonds, Pollution Control Series AG".

In case of the happening of an event of default as specified in said indenture and in the supplemental indenture dated March 1, 1942 supplemental thereto, the principal sum of the Bonds of this issue may be declared or may become due and payable forthwith, in the manner and with the effect in said indenture provided.

The Bonds of this series are subject to redemption as provided in said supplemental indenture dated June 1, 2012.

This Bond is transferable, but only as provided in the Authority Indenture upon surrender hereof, by the registered owner in person or by attorney duly authorized in writing, at the office of the Trustee; upon any such transfer a new Bond similar hereto will be issued to the transferee. No service charge shall be made for any such transfer, but the Company may require payment of a sum sufficient to cover any tax or other governmental charge that may be imposed in relation thereto. The Company and the Trustee and any paying agent may deem and treat the person in whose name this Bond is registered as the absolute owner hereof for the purpose of receiving payment of or on account of the principal hereof and the interest hereon and for all other purposes; and neither the Company nor the Trustee nor any paying agent shall be affected by any notice to the contrary.

The Bonds of this series are issuable only in fully registered form, in any denomination authorized by the Company.

No recourse under or upon any obligation, covenant or agreement contained in said indenture or in any indenture supplemental thereto, or in any Bond or coupon issued thereunder, or because of any indebtedness arising thereunder, shall be had against any incorporator, or against any past, present or future stockholder, officer or director, as such, of the Company or of any successor corporation, either directly or through the Company or any successor corporation, under any rule of law, statute or constitutional provision or by the enforcement of any assessment or by any legal or equitable proceeding or otherwise; it being expressly agreed and understood that said indenture, any indenture supplemental thereto and the obligations issued thereunder, are solely corporate obligations, and that no personal liability whatever shall attach to, or be incurred by, such incorporators, stockholders, officers or directors, as such, of the Company, or of any successor corporation, or any of them, because of the incurring of the indebtedness thereby authorized, or under or by reason of any of the obligations, covenants or agreements contained in the indenture or in any indenture supplemental thereto or in any of the Bonds or coupons issued thereunder, or implied therefrom.

This Bond shall not be entitled to any security or benefit under said indenture, as amended and supplemented, and shall not become valid or obligatory for any purpose, until the certificate of authentication, hereon endorsed, shall have been signed by U.S. Bank National Association, as Trustee, or by its successor in trust under said indenture.

IN WITNESS WHEREOF, the Company has caused this Bond to be duly executed by its proper officers under its corporate seal.

Dated

PUBLIC SERVICE ELECTRIC AND GAS COMPANY,

By. . . . .
(Vice) President

(Seal)

Attest:

. . . .
(Assistant) Secretary

[FORM OF CERTIFICATE OF AUTHENTICATION]
CERTIFICATE OF AUTHENTICATION

This Bond is one of the Bonds of the series designated therein which are described in the within-mentioned indenture and supplemental indenture dated June 1, 2012, as secured thereby.

U.S. BANK NATIONAL ASSOCIATION, TRUSTEE,

By. . . . . Authorized Signatory

WHEREAS, the execution and delivery of this supplemental indenture have been duly authorized by the Board of Directors of the Company; and

WHEREAS, the Company represents that all things necessary to make the bonds of the Pollution Control Series AG hereinafter described, when duly authenticated by the Trustee and issued by the Company, valid, binding and legal obligations of the Company, and to make this supplemental indenture a valid and binding agreement supplemental to the Indenture, have been done and performed:

NOW, THEREFORE, THIS SUPPLEMENTAL INDENTURE WITNESSETH that the Company, in consideration of the premises and the execution and delivery by the Trustee of this supplemental indenture, and in pursuance of the covenants and agreements contained in the Indenture and for other good and valuable consideration, the receipt of which is hereby acknowledged, has granted, bargained, sold, aliened, remised, released, conveyed, confirmed, assigned, transferred and set over, and by these presents does grant, bargain, sell, alien, remise, release, convey, confirm, assign, transfer and set over unto the Trustee, its successors and assigns, forever, all the right, title and interest of the Company in and to all property of every kind and description (except cash, accounts and bills receivable and all merchandise bought, sold or manufactured for sale in the ordinary course of the Company's business, stocks, bonds or other corporate obligations or securities, other than such as are described in Part V of the Granting Clauses of the Indenture, not acquired with the proceeds of bonds secured by the Indenture, and except as in the Indenture and herein otherwise expressly excluded) acquired by the Company since the execution and delivery of the supplemental indenture dated May 1, 2012, supplemental to the Indenture (except any such property duly released from, or disposed of free from, the lien of the Indenture, in accordance with the provisions thereof) and all such property which at any time hereafter may be acquired by the Company;

All of which property it is intended shall be included in and granted by this supplemental indenture and covered by the lien of the Indenture as heretofore and hereby amended and supplemented;

UNDER AND SUBJECT to any encumbrances or mortgages existing on property acquired by the Company at the time of such acquisition and not heretofore discharged of record; and

SUBJECT, also, to the exceptions, reservations and provisions in the Indenture and in this supplemental indenture recited, and to the liens, reservations, exceptions, limitations, conditions and restrictions imposed by or contained in the several deeds, grants, franchises and contracts or other instruments through which the Company acquired or claims title to the aforesaid property; and subject, also, to existing leases, to liens on easements or rights of way, to liens for taxes, assessments and governmental charges not in default or the payment of which is deferred, pending appeal or other contest by legal proceedings, pursuant to Section 4 of Article Five of the Indenture, or the payment of which is deferred pending billing, transfer of title or final determination of amount, to easements for alleys, streets, highways, rights of way and railroads that may run across or encroach upon the said property, to joint pole and similar agreements, to undetermined liens and charges, if any, incidental to construction, and other encumbrances permitted by the Indenture as heretofore and hereby amended and supplemented;

TO HAVE AND TO HOLD the property hereby conveyed or assigned, or intended to be conveyed or assigned, unto the Trustee, its successor or successors and assigns, forever;

IN TRUST, NEVERTHELESS, upon the terms, conditions and trusts set forth in the Indenture as heretofore and hereby amended and supplemented, to the end that the said property shall be subject to the lien of the Indenture as heretofore and hereby amended and supplemented, with the same force and effect as though said property had been included in the Granting Clauses of the Indenture at the time of the execution and delivery thereof;

AND THIS SUPPLEMENTAL INDENTURE FURTHER WITNESSETH that for the considerations aforesaid, it is hereby

covenanted between the Company and the Trustee as follows: ARTICLE I.

BONDS OF THE POLLUTION CONTROL SERIES AG.

The series of bonds authorized by this supplemental indenture to be issued under and secured by the Indenture shall be designated "First and Refunding Mortgage Bonds, Pollution Control Series AG"; shall be limited to the aggregate principal amount of $50,000,000; shall be issued initially to the Authority Trustee, as assignee of the

Authority, to evidence the Company's obligation to repay the loan to refinance a portion of the costs of the Project made pursuant to the Pollution Control Facilities Loan Agreement; and shall mature and bear interest as set forth in the form of bond hereinbefore described; provided, however, that the Company shall receive certain credits against principal and interest obligations as set forth in Section 3.01 hereof. The date of each bond of the Pollution Control Series AG shall be the interest payment date next preceding the date of authentication, unless such date of authentication be an interest payment date, in which case the date shall be the date of authentication, or unless such date of authentication be prior to the first interest payment date, in which case the date shall be June 1, 2012.

Bonds of the Pollution Control Series AG shall be issued as fully registered bonds in any denomination authorized by the Company. Interest on bonds of the Pollution Control Series AG shall be payable at such time and in such manner as interest is payable on the 2012 Authority Bonds, subject to certain credits against principal and interest as set forth in Section 3.01 hereof and shall be payable as to both principal and interest in such coin or currency of the United States of America as at the time of payment shall constitute legal tender for the payment of public and private debts, at the principal office of the Trustee, or at the corporate trust office of any paying agent appointed by the Company.

Bonds of the Pollution Control Series AG shall be transferable (but only as provided in the Authority Indenture) upon surrender thereof for cancellation by the registered owner in person or by attorney duly authorized in writing at said office of the Trustee.

The Company hereby waives any right to make a charge for any transfer of bonds of the Pollution Control Series AG, but the Company may require payment of a sum sufficient to cover any tax or other governmental charge that may be imposed in relation thereto.

ARTICLE II.

REDEMPTION OF BONDS—POLLUTION CONTROL SERIES AG.

SECTION 2.01. *Redemption—Redemption Prices.* Bonds of the Pollution Control Series AG shall be subject to redemption prior to maturity, under the conditions and upon the payment of the amounts specified in the following subsections, together, in each case, with interest accrued to the redemption date:

(a) At the option of the Company:

(i) whenever the Interest Rate Mode for the 2012 Authority Bonds is the Daily Rate, the Weekly Rate, or the Semi-Annual Rate ,in whole or in part on any date, at a redemption price of 100% of the principal amount thereof;

(ii) whenever the Interest Rate Mode for the 2012 Authority Bonds is the Commercial Paper Rate, in whole or in part, at a redemption price of 100% of the principal amount thereof on the Interest Payment Date for each Commercial Paper Rate Period for a 2012 Authority Bond or Bonds, such redemption to be in the same principal amount of such 2012 Authority Bond or Bonds;

(iii) whenever the Interest Rate Mode for the 2012 Authority Bonds is the Auction Rate, in whole or in part, at a redemption price of 100% of the principal amount thereof on the final Interest Payment Date for each Auction Period;

(iv) whenever the Interest Rate Mode for the 2012 Authority Bonds is the Term Rate, in whole or in part, on the final Interest Payment Date for the then current Term Rate Period at a redemption price of 100% of the principal amount thereof plus accrued interest, if any, to the redemption date, and, prior to the end of the then current Term Rate Period, at any time during the redemption periods and at the redemption prices set forth below, plus accrued interest, if any, to the redemption date:

Original Length of Current Term Rate Period (Years)	Commencement of Redemption Period	Redemption Price as Percentage of Principal
More than 15 years	Tenth anniversary of commencement of Term Rate Period	100%
Greater than 10 years but equal to or less than 15 years	Fifth anniversary of commencement of Term Rate Period	100%
Equal to or less than 10 years	Non-callable	Non-callable

If, at the time of the Company's notice of a change in the Term Rate Period pursuant to Section 2.02(d) of the Authority Indenture, or its notice of Conversion of the Interest Rate Mode for the 2012 Authority Bonds to the Term Rate pursuant to Section 2.02(e) of the Authority Indenture, or, when the Interest Rate Mode for the 2012 Authority Bonds is the Term Rate, at least 35 days prior to the Purchase Date for the 2012 Authority Bonds pursuant to Section 3.01 (b)(i) of the Authority Indenture, the Company provides a certification of the Remarketing Agent to the Authority Trustee and the Authority that the foregoing schedule is not consistent with Prevailing Market Conditions and an opinion of Bond Counsel that a change in the redemption provisions of the 2012 Authority Bonds will not adversely affect the exclusion from gross income of interest on the 2012 Authority Bonds for federal income tax purposes, the foregoing redemption periods and redemption prices may be revised effective as of the date of such change in the Term Rate Period, the Conversion Date, or that Purchase Date, as determined by the Remarketing Agent in its judgment, taking into account the then Prevailing Market Conditions, as stipulated in such certification, which shall be appended by the Trustee to its counterpart of this supplemental indenture. Any such revision of the redemption periods and redemption prices shall not be considered an amendment of or a supplement to this supplemental indenture and shall not require the consent of any other person or entity.

(v) whenever the Interest Rate Mode for 2012 Authority Bonds is the Annual Rate, in whole or in part, at a redemption price equal to 100% of the principal amount thereof on the final Interest Payment Date for such Annual Rate Period.

(b) Special Mandatory Redemption: in whole (or in part, if in the opinion of Bond Counsel such partial redemption will preserve the exclusion from gross income for federal income tax purposes of interest on the 2012 Authority Bonds remaining outstanding after such redemption) at any time at a redemption price of 100% of the principal amount thereof, plus interest accrued to the redemption date, if a "final determination" (as defined in the Authority Indenture) is made that the interest paid or payable on any 2012 Authority Bond to other than a "substantial user" of the Project or a "related person" (within the meaning of Section 147(a) of the Code) is or was includable in the gross income of the owner thereof for federal income tax purposes under the Code as a result of the failure by the Company to observe or perform any covenant, condition or warranty on its part to be observed or performed under the Agreement or the inaccuracy of any representation or warranty by the Company under the Agreement and under the Use of Proceeds Certificate of the Company dated the Closing Date. Any special mandatory redemption shall be made as soon as practicable but in any event not more than 180 days from the date of such "final determination" and shall be on the date specified by the Company pursuant to Section 8.01(b) of the Authority Indenture or, if no date is so specified, the date established by the Authority Trustee in accordance with Section 8.01(b) of the Authority Indenture.

(c) in whole at 100% of the principal amount thereof whenever the Company receives from the Authority Trustee a copy of a written demand sent to the Trustee stating that the principal of all outstanding 2012 Authority Bonds has been declared to be immediately due and payable because of an Event of Default under the Authority Indenture. In such case, redemption of the bonds of the Pollution Control Series AG shall be any date selected by the Company, not more than 180 days after receipt by the Company of such written demand for redemption.

SECTION 2.02. *Notice of Redemption.* (a) The election of the Company under subsection (a) of Section 2.01 hereof to redeem any of the bonds of the Pollution Control Series AG shall be evidenced by a resolution of the Board of

Directors of the Company calling for redemption on a stated date of all or a stated principal amount thereof. To exercise its option to redeem the bonds of the Pollution Control Series AG under subsection (a) of Section 2.01 hereof, the Company shall deliver to the Trustee, the Authority and the Authority Trustee a certified copy of said resolution calling all or a stated principal amount of the bonds of the Pollution Control Series AG for redemption on a date not less than 20 days (35 days if the Interest Rate Mode is the Term Rate) nor more than 65 days from the date said resolution is delivered. The delivery to the Authority Trustee of a certified copy of such resolution shall constitute notice to the Authority Trustee of the redemption referred to therein, on the terms specified therein. The Company shall on or before such redemption date deposit with the Trustee, as paying agent hereunder, the total applicable redemption price of all the bonds so called, with interest accrued thereon to the redemption date, less any credits to which the Company may be entitled pursuant to Section 3.01 hereof, and the Trustee, as such paying agent, shall apply such funds on the redemption date to the redemption of the bonds so called.

(b) The Company shall, within 10 days after the occurrence of a "final determination" under subsection (b) of Section 2.01 hereof, deliver to the Trustee written notice of such "final determination". The Company shall, by resolution of its Board of Directors, fix a redemption date for such redemption and shall deliver to the Trustee, the Authority and the Authority Trustee a certified copy of said resolution not later than 60 days after a "final determination" is made and at least 40 days prior to the date so selected for redemption. Such redemption date may be any day not more than 180 days after the occurrence of such "final determination". If the Trustee does not receive written notice of such selection by the Company within 60 days after the date of the occurrence of such "final determination," then the redemption date shall be the redemption date established by the Authority Trustee in accordance with Section 8.01(b) of the Authority Indenture. On or before such redemption date, the Company shall deposit with the Trustee, as paying agent hereunder, the total redemption price of the bonds so called, with interest accrued thereon to the redemption date, less any credits to which the Company may be entitled pursuant to Section 3.01 hereof, and the Trustee, as such paying agent, shall apply such funds, on the redemption date, to the redemption of the bonds so called. The delivery to the Authority Trustee of a certified copy of such resolution shall constitute notice to the Authority Trustee of the redemption referred to therein on the terms specified therein.

SECTION 2.03. *Interest on Called Bonds to Cease.* Each bond or portion thereof of the Pollution Control Series AG called for redemption under Section 2.02 hereof shall be due and payable at the office of the Trustee, as paying agent hereunder, at the applicable redemption price and on the specified redemption date, anything herein or in such bond to the contrary notwithstanding. From and after the date when each bond or portion thereof of the Pollution Control Series AG shall be due and payable as aforesaid (unless upon said date the full amount due thereon shall not be held by or provided to the Trustee, as paying agent hereunder, and be immediately available for payment), all further interest shall cease to accrue on such bond or on such portion thereof, as the case may be.

SECTION 2.04. *Bonds Called in Part.* If only a portion of any bond of the Pollution Control Series AG shall be called for redemption pursuant to Section 2.02 hereof, the notice of redemption hereinbefore provided for shall specify the portion of the principal amount thereof to be redeemed. Upon payment of the portion so called for redemption, the Trustee, as paying agent hereunder, shall give prompt written notice thereof to the Company.

SECTION 2.05. *Provisions of Indenture Not Applicable.* The provisions of Article Four of the Indenture, as amended and supplemented, shall not apply to the procedure for the exercise of any right of redemption reserved by the Company, or to any mandatory redemption provided in this Article in respect of the bonds of the Pollution Control Series AG. There shall be no sinking fund for the bonds of the Pollution Control Series AG.

ARTICLE III.

CREDITS WITH RESPECT TO THE BONDS OF THE POLLUTION CONTROL SERIES AG.

SECTION 3.01. *Credits.* (a) In addition to any other credit, payment or satisfaction to which the Company is entitled with respect to the bonds of the Pollution Control Series AG, the Company shall be entitled to credits against amounts otherwise payable in respect of the bonds of the Pollution Control Series AG in an amount corresponding to the amount by which interest due on the bonds of the Pollution Control Series AG exceeds the interest due on the 2012 Authority Bonds.

(b) The Company shall be entitled to credits against amounts otherwise payable in respect of the bonds of the Pollution Control Series AG in an amount corresponding to (i) the principal amount of any 2012 Authority Bond surrendered to the Authority Trustee by the Company or the Authority, or purchased by the Authority Trustee, for cancellation and (ii) the amount of money held by the Authority Trustee and available and designated for or applied toward the payment of principal or redemption price of and interest on the 2012 Authority Bonds, as the case may be, regardless of the source of payment to the Authority Trustee of such moneys. The Trustee, as paying agent hereunder, shall give prompt written notice to the Company of any such credit with respect to the payment of interest.

(c) The Trustee, as paying agent hereunder, shall (i) promptly notify the Company of each deposit in the Debt Service Fund under the Authority Indenture, (ii) provide evidence to the Company that such deposit has been credited to such Fund and (iii) give prompt written notice to the Company of any credits with respect to payment of principal or redemption price of and interest on the bonds of the Pollution Control Series AG.

SECTION 3.02. *Certificate of the Company.* A certificate of the Company signed by the President, any Vice President or any Assistant Treasurer, and attested to by the Secretary or any Assistant Secretary, and consented to by the Authority Trustee, stating that the Company is entitled to a credit under Section 3.01 hereof and setting forth the basis therefor in reasonable detail, shall be conclusive evidence of such entitlement, and the Trustee shall accept such certificate as such evidence without further investigation or verification of the matters stated therein.

ARTICLE IV.

MISCELLANEOUS.

SECTION 4.01. *Authentication of Bonds of Pollution Control Series AG.* None of the bonds of the Pollution Control Series AG, the issue of which is provided for by this supplemental indenture, shall be authenticated by the Trustee except in accordance with the provisions of the Indenture, as amended and supplemented, and this supplemental indenture, and upon compliance with the conditions in that behalf therein contained.

SECTION 4.02. *Additional Restrictions on Authentication of Additional Bonds Under Indenture.* The Company covenants that from and after the date of execution of this supplemental indenture, no additional bonds (as defined in Section I of Article Two of the Indenture) shall be authenticated and delivered by the Trustee under Subdivision A of Section 4 of said Article Two on account of additions or improvements to the mortgaged property:

(1) unless the net earnings of the Company for the period required by Subdivision C of Section 6 of said Article Two shall have been at least twice the fixed charges (in lieu of $1\frac{3}{4}$ times such fixed charges, as required by said Subdivision C); and for the purpose of this condition (a) such fixed charges shall in each case include interest on the bonds applied for, notwithstanding the parenthetical provision contained in clause (4) of said Subdivision C, and (b) in computing such net earnings there shall be included in expenses of operation (under paragraph (c) of said Subdivision C) all charges against earnings for depreciation, renewals or replacements, and all certificates with respect to net earnings delivered to the Trustee in connection with any authentication of additional bonds under said Article Two shall so state; and

(2) except to the extent of 60% (in lieu of 75% as permitted by Subdivision A of Section 7 of said Article Two) of the cost or fair value to the Company of the additions or improvements forming the basis for such authentication of additional bonds.

SECTION 4.03. *Restriction on Dividends.* The Company will not declare or pay any dividend on any shares of its common stock (other than dividends payable in shares of its common stock) or make any other distribution on any such shares, or purchase or otherwise acquire any such shares (except shares acquired without cost to the Company) whenever such action would reduce the earned surplus of the Company to an amount less than $10,000,000 or such lesser amount as may remain after deducting from said $10,000,000 all amounts appearing in the books of account of the Company on December 31, 1948, which shall thereafter, pursuant to any order or rule of any regulatory body entered after said date, be required to be removed, in whole or in part, from the books of account of the Company by charges to earned surplus.

SECTION 4.04. *Use of Facsimile Seal and Signatures.* The seal of the Company and any or all signatures of the officers of the Company upon any of the bonds of the Pollution Control Series AG may be facsimiles.

SECTION 4.05. *Effective Period of Supplemental Indenture.* The preceding provisions of Articles I, II and III of this supplemental indenture shall remain in effect only so long as any of the bonds of the Pollution Control Series AG shall remain outstanding.

SECTION 4.06. *Time for Making of Payment.* All payments of principal or redemption price of and interest on the bonds of the Pollution Control Series AG shall be made to the Authority Trustee in such funds as shall constitute immediately available funds when payment is due. In any case where the date of payment of the principal or redemption price of or interest on the bonds of the Pollution Control Series AG or the date fixed for redemption of any such bonds shall be in the city of payment a Saturday, Sunday or a legal holiday or a day on which banking institutions are authorized by law to close, then such payment need not be made on such date but may be made on the next succeeding business day with the same force and effect as if made on the date of maturity or the date fixed for redemption, and no interest on such payment shall accrue for the period after such date.

Section 4.07. *Effect of Approval of Board of Public Utilities of the State of New Jersey.* The approval of the Board of Public Utilities of the State of New Jersey of the execution and delivery of these presents and of the issue of any bonds of the Pollution Control Series AG shall not be construed as approval of said Board of any other act, matter or thing which requires approval of said Board under the laws of the State of New Jersey.

Section 4.08. *Execution in Counterparts.* For the purpose of facilitating the recording hereof, this supplemental indenture has been executed in several counterparts, each of which shall be and shall be taken to be an original, and all collectively but one instrument.

IN WITNESS WHEREOF, Public Service Electric and Gas Company, party hereto of the first part, after due corporate and other proceedings, has caused this supplemental indenture to be signed and acknowledged or proved by its President or one of its Vice Presidents and its corporate seal hereunto to be affixed and to be attested by the signature of its Secretary or an Assistant Secretary; and U.S. Bank National Association, as Trustee, party hereto of the second part, has caused this supplemental indenture to be signed and acknowledged or proved by its President, one of its Vice Presidents or one of its Assistant Vice Presidents and its corporate seal to be hereunto affixed and to be attested by the signature of one of its Vice Presidents, Assistant Vice Presidents, its Cashier, one of its Assistant Cashiers, or one of its Corporate Trust Officers. Executed and delivered this 11 th day of June, 2012.

PUBLIC SERVICE ELECTRIC AND GAS COMPANY

By /s/ B.D. Huntington
. . . .
B. D. Huntington
Vice President

Attest:
/s/ M. Courtney McCormick
. . . .
M. Courtney McCormick
Secretary

U.S. BANK NATIONAL ASSOCIATION

By /s/ N. Barnes
. . . .
N. Barnes
Vice President

Attest:
/s/ P. O'Brien
. . . .
P. O’Brien
Vice President

STATE OF NEW JERSEY)

SS:)

COUNTY OF ESSEX)

BE IT REMEMBERED, that on this 11th day of June, 2012, before me, the subscriber, a Notary Public of the State of New Jersey, personally appeared B. D. Huntington who, I am satisfied, is a Vice President of PUBLIC SERVICE ELECTRIC AND GAS COMPANY, one of the corporations named in and which executed the foregoing instrument, and is the person who signed the said instrument as such officer for and on behalf of such corporation, and I having first made known to him the contents thereof, he did acknowledge that he signed the said instrument as such officer, that the said instrument was made by such corporation and sealed with its corporate seal, that the said instrument is the voluntary act and deed of such corporation, made by virtue of authority from its Board of Directors, and that said corporation, the mortgagor, has received a true copy of said instrument.

/s/ Susan Costello
. . . .
Susan Costello
Notary Public of New Jersey
My Commission Expires March 26, 2017

STATE OF NEW JERSEY)

SS:)

COUNTY OF ESSEX)

BE IT REMEMBERED, that on this 11th day of June, 2012, before me, the subscriber, a Notary Public of the State of New Jersey, personally appeared N. Barnes who, I am satisfied, is a Vice President of U.S. BANK NATIONAL ASSOCIATION, one of the corporations named in and which executed the foregoing instrument, and is the person who signed the said instrument as such officer, for and on behalf of such corporation, and I having first made known to him the contents thereof, he did acknowledge that he signed the said instrument as such officer, that the said instrument was made by such corporation and sealed with its corporate seal; and that the said instrument is the voluntary act and deed of such corporation, made by virtue of authority from its Board of Directors.

/s/ Melody A. Simpson

. . . .
Melody A. Simpson
Notary Public of New Jersey
My Commission Expires March 1, 2016

CERTIFICATE OF RESIDENCE

U.S. Bank National Association, Mortgagee and Trustee within named, hereby certifies that its precise residence is 21 South Street, Morristown, New Jersey 07960

U. S. BANK NATIONAL ASSOCIATION

By /s/ N. Barnes

. . . .

N. Barnes

Vice President

Exhibit 10a(11) (PSEG)
Exhibit 10a(9) (Power)
Exhibit 10a(10) (PSE&G)

KEY EXECUTIVE SEVERANCE PLAN OF PUBLIC SERVICE ENTERPRISE GROUP INCORPORATED

Amended effective December 17, 2012

ARTICLE I

PURPOSE OF THE PLAN

1.1 Purpose The Key Executive Severance Plan of Public Service Enterprise Group Incorporated ("Plan") is maintained by the Company to provide severance benefits to certain key executive-level employees of the Company and its affiliates whose employment is terminated under the circumstances described herein. The Plan is being amended and restated effective December 17, 2012.

The Plan is intended to comply in operation and form with Section 409A to the Internal Revenue Code of 1986, as amended ("Code"). The timing and form of payment of benefits provided under the Plan will be deemed to be automatically modified, and a Participant's rights under the Plan will be limited so as to conform to any requirements under Section 409A of the Code.

ARTICLE II

DEFINITIONS

2.1 "Accrued Obligation" shall have the meaning set forth in Section 4.1 or 5.1 of the Plan.

2.2 "Affiliate" means any corporation, trade or business if it or the Company are members of a controlled group of corporations, are under common control or are members of an affiliated service group, within the meanings of Sections 414(b), 414(c) and 414(m), respectively, of the Code. The term "Affiliate" shall also include any other entity required to be aggregated with the Company pursuant to regulations under Section 414(o) of the Code.

2.3 "Annual Base Salary" means the annual rate of base salary payable to a Participant for services performed for an Employer, as in effect immediately prior to the Participant's Date of Termination.

2.4 "Board" means the board of directors of the Company.

2.5 "Cause" means:

(a) For purposes of Article IV:

(i) Misconduct, gross negligence, theft, or fraud against the Company;

(ii) For "Performance Reasons," as defined in Section 2.21 of the Plan;

(iii) Violation of the Standards of Integrity or other Company policy;

(iv) Insubordination;

(v) One or more significant acts of dishonesty;

(vi) Any act that is likely to have the effect of injuring the reputation, business, or business relationship of, the Company, its Board of Directors, Officers, or employees, or its affiliates or subsidiaries;

(vii) Violation of any fiduciary duty;

(viii) Breach of any duty of loyalty;

(ix) Any breach of the restrictive covenants contained in Exhibit I below;

(x) One or more acts of moral turpitude that constitute a violation of applicable law (included but not limited to a felony); or

(xi) Conviction of a felony or plea of *nolo contendere* to a felony charge.

(b) For purposes of Article V:

(i) The willful and continued failure to substantially perform his employment duties;

(ii) The willful engaging in gross misconduct that is materially and demonstrably injurious to the Employer;

(iii) The willful violation of the Company's Standards of Integrity or other applicable corporate code of conduct, or

(iv) The conviction of a felony or a plea of *nolo contetendere* to a felony charge.

No act or failure to act on the part of the Participant shall be considered "willful" unless it is done, or omitted to be done, by the Participant in bad faith or without reasonable belief that the Participant's action or omission was in the best interests of the Employer. Any act or failure to act that is based upon authority given pursuant to a resolution duly adopted by the Board, or the advice of counsel for the Employer, shall be conclusively presumed to be done, or omitted to be done, by the Participant in good faith and in the best interests of the Employer.

Notwithstanding the forgoing, for purposes of the Plan, the termination of a Participant's employment with an Employer shall not be deemed to be for Cause unless such termination is effected in accordance with the following procedures. The Employer shall give the Participant written notice ("Notice of Termination for Cause") of its intention to terminate the Participant's employment for Cause, setting forth in reasonable detail the specific conduct of the Participant that it considers to constitute Cause. Such notice shall be given no later than 60 days after the act or failure (or the last in a series of acts or failures) that the Employer alleges to constitute Cause. The Participant shall have 30 days after receiving the Notice of Termination for Cause in which to cure such act or failure, to the extent such cure is possible. In the case of a termination under clause (a), (b) or (c) above, if the Participant fails to cure such act or failure to the reasonable satisfaction of the Employer, the Employer shall give the Participant a second written notice stating that in the good faith opinion of the Employer, the Participant is guilty of the conduct described in the Notice of Termination for Cause and that such conduct constitutes Cause under the Plan.

2.6 "Change in Control" means the occurrence of any of the following events:

(a) Any "person" (within the meaning of Section 13(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act") is or becomes the beneficial owner within the meaning of Rule 13d-3 under the Exchange Act (a "Beneficial Owner"), directly or indirectly, of securities of the Company (not including in the securities beneficially owned by such person any securities acquired directly from the Company or its Affiliates) representing 25% or more of the combined voting power of the Company's then outstanding securities, excluding any person who becomes such a Beneficial Owner in connection with a transaction described in clause (i) of paragraph (c) below; or

(b) The following individuals cease for any reason to constitute a majority of the number of directors of the Company then serving: individuals who, on the Effective Date, constitute the Board and any new director (other than a director whose initial assumption of office is in connection with an actual or threatened election contest, including but not limited to a consent solicitation, relating to the election of directors of the Company) whose appointment or election by the Board or nomination for election by the Company's stockholders was approved or recommended by a vote of at least two-thirds of the directors then still in office who either were directors on the Effective Date or whose appointment, election or nomination for election was previously so approved or recommended; or

(c) There is consummated a merger or consolidation of the Company or any direct or indirect wholly-owned subsidiary of the Company with any other corporation, other than (i) a merger or consolidation which would result in the voting securities of the Company outstanding immediately prior to such merger or consolidation continuing to represent (either by remaining outstanding or by being converted into voting securities of the surviving entity or any parent thereof), in combination with the ownership of any trustee or other fiduciary holding securities under an employee benefit plan of the Company or of its Affiliates, at least 75% of the combined voting power of the securities of the Company or such surviving entity or any parent thereof outstanding immediately after such merger or consolidation, or (ii) a merger or consolidation effected to implement a recapitalization of the Company (or similar transaction) in which no person is or becomes the Beneficial Owner, directly or indirectly, of securities of the Company representing 25% or more of the combined voting power of the Company's then outstanding securities; or

(d) The shareholders of the Company approve a plan of complete liquidation or dissolution of the Company or there is consummated an agreement for the sale or disposition by the Company of all or substantially all of the Company's assets, other than a sale or disposition by the Company of all or substantially all of the Company's assets to an entity, at least 75% of the combined voting power of the voting securities of which are owned by stockholders of the Company in substantially the same proportions as their ownership of the Company immediately prior to such sale.

Notwithstanding the foregoing, a "Change in Control" shall not be deemed to have occurred by virtue of the consummation of any transaction or series of integrated transactions immediately following which the record holders of the common stock of the Company immediately prior to such transaction or series of transactions continue to have substantially the same proportionate ownership in an entity which owns all or substantially all of the assets of the Company immediately following such transaction or series of transactions.

2.7 "<u>Code</u>" means the Internal Revenue Code of 1986, as amended, and the regulations promulgated thereunder.

2.8 "<u>Committee</u>" means the Organization and Compensation Committee of the Board or any successor of such Committee.

2.9 "<u>Company</u>" means Public Service Enterprise Group Incorporated and any successors thereto.

2.10 "<u>Confidential Information</u>" means all trade secrets, proprietary and confidential business information belonging to, used by, or in the possession of the Company or any of its Affiliates, including but not limited to information, knowledge or data related to business strategies, plans and financial information, mergers, acquisitions or consolidations, purchase or sale of property, leasing, pricing, sales programs or tactics, actual or past sellers, purchasers, lessees, lessors or customers, those with whom the Company or its Affiliates has begun negotiations for new business, costs, employee compensation, marketing and development plans, inventions and technology, whether such confidential information, knowledge or data is oral, written or electronically recorded or stored, except information in the public domain, information known by the Participant prior to employment with an Employer, and information received by the Participant from sources other than the Company or its Affiliates, without obligation of confidentiality.

2.11 "<u>Date of Termination</u>" means the date of a Participant's death, Disability Effective Date, or the date on which the termination of the Participant's employment by an Employer for Cause or without Cause or by the Participant for Good Reason or without Good Reason, including Retirement, is effective, as the case may be, provided that the termination constitutes a Separation from Service.

2.12 "<u>Disability</u>" means that the Participant (a) is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than 12 months, or (b) is, by reason of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than 12 months, receiving income replacement benefits for a period of not less than three months under an accident or health plan covering employees of an Employer.

2.13 "<u>Disability Effective Date</u>" means the 30th day after the Participant's receipt of written notice of the Employer's intention to terminate the Participant's employment on account of Disability, provided that, within the 30 days after the Participant's receipt of such notice, the Participant shall not have returned to full-time performance of his employment duties.

2.14 "Eligible Employee" means an individual who is designated as such in accordance with Section 3.1.

2.15 "Effective Date" of the amendment and restatement is December 17, 2012.

2.16 "Employer" means the Company and each Affiliate, and any successors thereto.

2.17 "Good Reason" means:

(a) Any material reduction in the Participant's Annual Base Salary, Target Bonus or Target Long-Term Incentive, other than reductions pursuant to a broad-based compensation reduction program or policy affecting the Participant and all similarly situated employees of the Employer;

(b) Any material adverse change in the Participant's title, authority, duties, or responsibilities or the assignment to the Participant of any duties or responsibilities inconsistent in any respect with those customarily associated with the position of the Participant immediately prior to the Change in Control;

(c) The failure of any successor to the Company to assume this Plan in accordance with Section 11.5(b);

(d) Where the only comparable position offered to the Participant within the Employer following a Change in Control would otherwise meet the requirements of subsections (a) and (b) of this Section 2.17 of the Plan, but would require the Participant to increase his or her one-way commuting distance from his or her principal residence by more than 50 miles; or

(e) Any other material breach of the terms of the Plan by the Company that either is not taken in good faith or, even if taken in good faith, is not remedied by the Company promptly after receipt of notice thereof from the Participant.

Notwithstanding the forgoing, for purposes of the Plan, the termination of a Participant's employment with an Employer shall not be deemed to be for Good Reason unless such termination is effected in accordance with the following procedures. The Participant shall give his Employer a written notice ("Notice of Termination for Good Reason") of the termination, setting forth in reasonable detail the specific acts or omissions of the Employer that constitute Good Reason and the specific provision(s) of the Plan on which the Participant relies. Unless the Committee determines otherwise, a Notice of Termination for Good Reason by the Participant must be made within 60 days after the Participant first has actual knowledge of the act or omission (or the last in a series of acts or omissions) that the Participant alleges to constitute Good Reason, and the Employer shall have 30 days from the receipt of such Notice of Termination for Good Reason to cure the conduct cited therein. A termination of employment by the Participant for Good Reason shall be effective on the final day of such 30-day cure period unless prior to such time the Employer has cured the specific conduct asserted by the Participant to constitute Good Reason to the reasonable satisfaction of the Participant.

For purposes of the Plan, a Participant's determination that an act or failure to act constitutes Good Reason shall be presumed to be valid unless such determination is decided to be unreasonable by the Committee or its delegate pursuant to Article IX.

2.18 "Nonqualified Plan" the Retirement Income Reinstatement Plan for Non-Represented Employees of Public Service Enterprise Group Incorporated.

2.19 "Other Benefits" shall have the meaning set forth in Articles IV and V, as applicable.

2.20 "Participant" means an Eligible Employee who has satisfied the conditions for participation in the Plan, as set out in Section 3.2, and is listed on either Schedule A or Schedule B hereto, as the same may be amended from time to time.

2.21 "Performance Reasons" means the Participant's failure meet the expectations established for his function in the Company as: (a) communicated to him by his manager during any performance review, or (b) may be communicated to him otherwise by his manager from time to time either orally or in writing.

2.22 "Plan" means this Key Executive Severance Plan of Public Service Enterprise Group Incorporated, as set forth herein and as may be amended, modified or supplemented from time to time.

2.23 "Prior Equity Awards" shall mean outstanding stock options, stock appreciation rights, restricted stock, restricted stock units, performance shares and performance shares units.

2.24 "Retirement" means a Separation from Service after the Participant has satisfied the eligibility requirements for early or normal retirement under the terms of the Retirement Plan in which the Participant participates. Notwithstanding the foregoing, for the purposes of determining benefit entitlements under Article V of the Plan, Retirement shall not include forced retirements or any termination by an Employer without Cause or voluntary termination by the Participant for Good Reason that occurs on a date on which the Participant is Retirement eligible.

2.25 "Retirement Plan" the retirement plan in which the Participant participates either the Pension Plan of Public Service Enterprise Group Incorporated or the Cash Balance Pension Plan of Public Service Enterprise Group Incorporated.

2.26 "Schedule A Participant" shall mean a Participant listed on Schedule A hereto.

2.27 "Schedule B Participant" shall mean a Participant listed on Schedule B hereto.

2.28 "Separation from Service" shall be deemed to have occurred if a Participant and the Company or any Affiliate reasonably anticipates, based on the facts and circumstances, that either:

(a) The Participant will not provide any additional services for the Company or an Affiliate after a certain date; or

(b) The level of bona fide services performed by the Participant after a certain date will permanently decrease to no more than 50 percent of the average level of bona fide services performed by the Participant over the immediately preceding 36 months.

(c) If a Participant is absent from employment due to military leave, sick leave or any other bona fide leave of absence authorized by the Company or an Affiliate and there is a reasonable expectation that the Participant will return to perform services for the Company or an Affiliate, a Separation from Service will not occur until the later of: (i) the first date immediately following the date that is six months after the date that the Participant was first absent from employment; or (ii) the date the Participant no longer retains a right to reemployment, to the extent the Participant retains a right to reemployment with the Company or any Affiliates under applicable law or by contract. If a Participant fails to return to work upon the expiration of any military leave, sick leave or other bona fide leave of absence where such leave is for less than six months, the Separation from Service shall occur as of the date of the expiration of such leave, unless a greater period is provided for under applicable law.

2.29 "Specified Employee" shall mean any individual who is a key employee (as defined in Section 416(i) of the Code without regard to Section 416(i)(5)) of the Code) of the Company at any time during the 12-month period ending on each December 31 (the "identification date"). If an individual is a key employee as of an identification date, the individual shall be treated as a Specified Employee for the 12-month period beginning on the April 1 following the identification date. Notwithstanding the foregoing, an individual shall not be treated as a Specified Employee unless any stock of the Company or an Affiliate is publicly traded on an established securities market or otherwise.

2.30 "Target Bonus" means the Participant's target annual bonus, if any, under the applicable annual incentive compensation plan of the Company for the fiscal year in which the Date of Termination occurs.

2.31 "Target Long-Term Incentive" means the Participant's target long-term incentive award, if any, under the applicable long-term incentive compensation plan of the Company.

ARTICLE III

ELIGIBILITY AND PARTICIPATION

3.1 Eligible Employees. Eligibility to participate in the Plan shall be limited to certain key executives of an Employer who (a) are not parties to individual employment or change in control agreements that provide for severance benefits, and (b) are designated, by duly adopted resolution of the Committee, as Eligible Employees.

3.2 Participation. As a condition to becoming a Participant and being entitled to the benefits and protections provided under the Plan, each Eligible Employee must execute and deliver to the Company, within 30 days after the later of the Effective Date and the date such individual is designated by the Committee as an Eligible Employee, a written agreement in the form attached hereto as Exhibit I (or in such other form as may be satisfactory to the Company) to be bound by the restrictive covenants set forth in Article VII. Schedules A and B hereto list the Eligible Employees who have satisfied the conditions for Plan participation and the date as of which each such Eligible Employee became a Participant. The Committee shall cause Schedules A and B to be updated from time to time to reflect the Participants who are currently participating in the Plan.

3.3 Release of Claims. Notwithstanding anything in the Plan to the contrary, payment of any benefits under the Plan is expressly contingent upon the Participant's execution and delivery to the Company, within 30 days after the Participant's Date of Termination, of a written agreement provided by the Company, wherein the Participant releases and discharges the Company and each of its Affiliates of any and all claims against the Company and its Affiliates related in any way to the Participant's employment with an Employer and the termination of such employment.

3.4 Committee Discretion. The Committee shall have the sole discretion to determine eligibility for benefits under the Plan.

ARTICLE IV

SEVERANCE BENEFITS IN GENERAL

4.1 Termination by Employer Other than for Cause or by the Participant for Good Reason. Subject to Section 3.3 and Article VI of the Plan, if a Participant's employment is involuntarily terminated by an Employer for reasons other than Cause or a Participant terminates employment for Good Reason, the Participant shall be entitled to the benefits described in Sections 4.2 through 4.9 of the Plan. For purposes of clarity, subject to Section 3.3 and Article VI of the Plan, Participant shall be entitled to the benefits described in Sections 4.2 through 4.9 of the Plan if a Participant's employment is involuntarily terminated by an Employer due to a reduction in force or a reorganization of the Employer (as determined by the Committee), or a Participant experiences a cessation of employment in connection with a reduction in force or Employer reorganization (as determined by the Committee) where the only position offered to the Participant within the Company and Affiliates would require the Participant to accept a reduction in his or her annual rate of base salary of more than 20% below the annual rate of base salary of the Participant's position immediately prior to such action.

For the avoidance of any doubt, a Participant shall not be entitled to benefits under the Plan if (i) his employment terminates as a result of death, Disability, the Participant voluntarily terminates employment, except for Good Reason, or (ii) the Participant's cessation of employment is in connection with the sale of the Participant's Employer, line or unit of business of the Employer within which the Participant's position is located, business function of the Employer within which the Participant's position is located, or the assets related to the Employer, line or unit or business, or business function within which the Participant's position is located, and the Participant accepts employment with the purchaser within 90 days of the closing of the transaction in a position that has an annual rate of base salary that is at least 80 percent of the Participant's annual rate of base salary immediately prior to the closing of the sale).

4.2 Cash payment. The Company shall pay to the Participant a lump sum, in cash, the sum of (a) and (b):

(a) The Participant's base salary and accrued vacation pay through the Date of Termination to the extent not theretofore paid (hereinafter referred to as the "Accrued Obligations"); and

(b) An amount equal to the product of 1.0 times (0.5 times if the Participant were employed less than one year) the sum of the Participant's Annual Base Salary and Target Bonus.

4.3 Long-Term Incentive Awards. The treatment of Prior Equity Awards shall be governed by the terms of the Long-Term Incentive Plan and the related award agreements.

4.4 Annual Incentive Awards. The Participant shall receive a prorated annual incentive award pursuant to the performance incentive program, if applicable, for the calendar year in which the Participant's Termination of Employment occurs. The award shall be calculated based solely on 100 percent of the target incentive award and prorated based on the number of calendar days of employment in the calendar year in which the Participant's termination occurs through the Participant's Date of Termination. For purposes of this Section 4.4, calendar year shall mean 365 days.

Annual incentive awards with respect to the calendar year in which a Participant's Date of Termination occurs will be paid at the same time as awards for such calendar year are paid to active employees of the Employer.

4.5 Outplacement Services. Outplacement services approved by the Committee, which may include individual or group counseling and administrative assistance or workshops, shall be available beginning on the Participant's Date of Termination or such earlier date designated by the Participant's business unit leadership. Outplacement services shall continue to be available for the period up to 12 months.

4.6 Educational Assistance. Educational assistance shall be provided in accordance with the Employer's tuition program.

4.7 Health Care Benefits.

(a) Retiree Health Care Coverage. A Participant who has not otherwise satisfied the eligibility criteria for participation prior to his Date of Termination, shall be entitled to elect retiree coverage under the Employer's applicable retiree group health care plans as though he or she otherwise satisfied such plans' eligibility requirements if:

(i) The Participant has attained age 50 and completed ten or more Years of Service as of his Date of Termination but the sum of the Participant's age and Years of Service is less than 80; or

(ii) The Participant has attained age 49 and completed 20 or more Years of Service as of his Date of Termination but the sum of the Participant's age and Years of Service is less than 80.

Such coverage shall commence no earlier than the Participant's Termination Date. The Participant shall be charged the full cost of retiree coverage under these plans.

(b) COBRA Continuation Coverage. Each Participant who is not eligible for, or does not elect, the retiree health care coverage described in this Section 4.7 of the Plan shall be entitled, pursuant to any continuation coverage rights under the Consolidated Omnibus Budget Reconciliation Act of 1985, as amended ("COBRA"), to continue individual and dependent coverage under the Company's group health care plans following the Participant's Date of Termination. If continuation coverage is elected, the Employer shall pay the same portion of the cost of medical coverage that it paid immediately prior to the Participant's Date of Termination for active employees during the one-year period following the Participant's Date of Termination, and the Participant shall pay the balance. The Participant shall be charged the full expense of medical coverage (102 percent of the cost of coverage) during the remainder of the COBRA coverage period, if any, and the full expense of dental and (if applicable) vision and hearing coverage (102 percent of the cost of coverage) during the entire COBRA coverage period.

4.8 Life Insurance. A Participant who is not eligible for coverage under the Employer's retiree life insurance plan shall be entitled, for the one-year period following the Participant's Date of Termination to life insurance coverage at the Employer's expense in an amount equal to the group term life insurance coverage in effect for such Participant under the Employer's group term life insurance plan for active employees as of his Date of Termination.

4.9 Other Benefits. A Participant shall not be entitled to any severance, separation or early retirement incentive pay or benefits other than as provided hereunder or under any qualified or nonqualified retirement plan or deferred compensation arrangement maintained by the Employer. Except as provided in the foregoing sentence, a Participant's rights under any other employee benefit plans maintained by the Company or an Affiliate shall be determined in accordance with the provisions of such plans, including the Company's right to amend or terminate such plans at any time. (The amounts and benefits payable to the Participant pursuant to Sections 4.3 through 4.9 of the Plan shall be hereinafter referred to as the "Other Benefits").

4.10 Termination where a Participant experiences a cessation of employment in connection with a reduction in force or Employer reorganization where the only position offered to the Participant within the Company and Affiliates would require the Participant to increase his or her one-way commuting distance by more than 50 miles. Subject to Section 3.3 and Article V, if a Participant experiences a cessation of employment in connection with a reduction in force or an Employer reorganization (as determined by the Committee) where the only position offered to the Participant within the Company and Affiliates would require the Participant to increase his or her one-way commuting distance by more than 50 miles:

(a) Severance Pay. The Participant shall receive a lump sum cash payment in accordance with Section 6.1 of the Plan, based upon the amount of the Participant's base salary, the number of Years of Service completed as of the Participant's Termination Date, as follows:

(i) **Less than Thirteen Years of Service:** If, as of the Participant's Date of Termination, he has completed fewer than thirteen Years of Service, the amount of severance pay shall equal 26 weeks of base salary.

(ii) **Thirteen or More Years of Service:** If, as of the Participant's Date of Termination, he has completed thirteen or more Years of Service, the amount of severance pay shall equal two weeks of base salary for each Year of Service, up to a maximum of 52 weeks of base salary.

(b) Annual Incentive Awards. A Participant shall receive a prorated annual incentive award pursuant to the performance incentive program, if applicable, for the calendar year in which the Participant's Termination of Employment occurs. The award shall be calculated based solely on 100 percent of the target incentive award and prorated based on the number of days of employment in the calendar year in which the participant's Termination of Employment occurs through the employee's Termination Date. Annual incentive awards with respect to the calendar year in which a Participant's Termination Date occurs will be paid at the same time as awards for such calendar year are paid to active employees of the Employer.

(c) Outplacement Services. Outplacement services approved by the Committee, which may include individual or group counseling and administrative assistance or workshops, shall be available beginning on the participant's Termination Date or such earlier date designated by the participant's business unit leadership. Outplacement services shall continue to be available for the period up to 12 months.

(d) Educational Assistance. Education assistance shall be provided in accordance with the Employer's tuition program.

(e) Health Care Benefits.

(i) Retiree Health Care Coverage. An Eligible Employee who has not otherwise satisfied the eligibility criteria for participation prior to his Date of Termination, shall be entitled to elect retiree coverage under the Employer's applicable retiree group health care plans as though he or she otherwise satisfied such plans' eligibility requirements if:

(A) The Participant has attained age 50 and completed ten or more Years of Service as of his Date of Termination but the sum of the Participant's age and Years of Service is less than 80; or

(B) The Participant has attained age 49 and completed 20 or more Years of Service as of his Date of Termination but the sum of the Participant's age and Years of Service is less than 80.

Such coverage shall commence no earlier than the Participant's Date of Date. The Participant shall be charged the full cost of retiree coverage under these plans.

(ii) COBRA Continuation Coverage. Each Participant who is not eligible for, or does not elect, the retiree health care coverage described in this subsection (i) shall be entitled, pursuant to any continuation coverage rights under COBRA to continue individual and dependent coverage under the Company's group health care plans following the Participant's Termination Date. If continuation coverage is elected, the Employer shall pay the same portion of the cost of medical coverage that it paid immediately prior to the Participant's Date of Termination for active employees during the period that the Participant would have received severance pay if severance pay had been paid in bi-weekly installments, and the Participant shall pay the balance. The Participant shall be charged the full expense of medical coverage (102 percent of the cost of coverage) during the remainder of the COBRA coverage period, if any, and the full expense of dental and (if applicable) vision and hearing coverage (102 percent of the cost of coverage) during the entire COBRA coverage period.

(f) Life Insurance. A Participant who is not eligible for coverage under the Employer's retiree life insurance plan shall be entitled during the period that the Participant would have received severance pay if severance pay had been paid in bi-weekly installments, to life insurance coverage at the Employer's expense in an amount equal to the group term life insurance coverage in effect for such Participant under the Employer's group term life insurance plan for active employees as of his Date of Termination Date.

(g) Other Benefits. A Participant shall not be entitled to any severance, separation or early retirement incentive pay or benefits other than as provided under the Plan or under any qualified or nonqualified retirement plan or deferred compensation arrangement maintained by the Employer. Except as provided in the foregoing sentence, a Participant's rights under any other employee benefit plans maintained by the Company or an Affiliate shall be determined in accordance with the provisions of such plans, including the Company's right to amend or terminate such plans at any time.

ARTICLE V
SEVERANCE BENEFITS AFTER A CHANGE IN CONTROL

5.1 Termination By Employer Other Than For Cause or By Participant For Good Reason (other than Good Reason as described in Subsection 2.17(d)) Within Two Years After a Change in Control. Subject to Section 3.3 and Article VI of the Plan, if, within two years following the occurrence of a Change in Control, either (a) an Employer shall terminate a Participant's employment other than for Cause or Disability, or (b) a Participant shall voluntarily terminate his employment for Good Reason pursuant to Subsections 2.17 (a), (b), (c) or (e), the Participant shall be entitled to benefits in Sections 5.2 through 5.8 of the Plan. For the avoidance of any doubt, a Participant shall not be entitled to benefits under the Plan if his employment terminates as a result of death, Disability or the Participant voluntarily terminates employment, except for Good Reason, except as otherwise provided under the Plan.

5.2 Cash Payment. The Company shall pay to the Participant, in a lump sum in cash, the aggregate of the amounts in (a) and (b) below:

(a) the sum of:

(i) The Participant's base salary and accrued through the Date of Termination; and

(ii) The product of (x) the Participant's Target Bonus and (y) a fraction, the numerator of which is the number of days in the current calendar year through the Date of Termination, and the denominator of which is 365;

in each case to the extent not theretofore paid (the sum of the amounts described in clauses (i) and (ii) shall be hereinafter referred to as the "Accrued Obligations"); and

(b) Either (i) or (ii):

(i) In the case of a Schedule A Participant, the amount equal to the product of two times the sum of the Schedule A Participant's Annual Base Salary and Target Bonus; or

(ii) In the case of a Schedule B Participant, the amount equal to the product of three times the sum of the Schedule B Participant's Annual Base Salary and Target Bonus.

5.3 Long Term Incentive Awards. The treatment of Prior Equity Awards shall be governed by the terms of the Long-Term Incentive Plan and the related award agreements.

5.4 Health Care and Other Welfare Benefits. The Company shall pay the cost of the continued coverage of the Participant and/or the Participant's family under the Company's medical and dental employee benefit plans for 18 months after the Date of Termination provided that the Participant makes an election to continue such coverage in the Company's medical and dental employee benefit plans under COBRA, subject to the requirements and limitations thereof. Unless otherwise limited by applicable law, thereafter, the Company shall pay the cost of the continued coverage of the Participant and/or the Participant's family under the Company's medical and dental employee benefit plans for an additional period of six months, in the case of a Schedule A Participant, or 18 months, in the case of a Schedule B Participant; provided however, that if the Participant becomes re-employed with another employer and is eligible to receive medical or dental benefits under another employer provided plan, the medical and dental benefits provided by the Company under this Plan shall be secondary to those provided under such other plan during the applicable period of eligibility.

Unless otherwise limited by applicable law, for two years after the Date of Termination in the case of a Schedule A Participant or three years after the Date of Termination in the case of a Schedule B Participant (or such longer period as may be provided by the terms of the appropriate plan, program, practice or policy), the Company shall continue benefits (other than medical and dental benefits) to the Participant and/or the Participant's family at least equal to those which would have been provided to them in accordance with the welfare plans, programs, practices and policies maintained by the Company if the Participant's employment had not been terminated or, if more favorable to the Participant, as in effect generally at any time thereafter with respect to other peer executives of the Employer and their families.

Unless otherwise limited by applicable law, the Participant's eligibility (but not the time of commencement of such benefits) for retiree benefits pursuant to the welfare plans, programs, practices and policies maintained by the Company shall be determined as if the Participant had (A) remained employed until two years (in the case of a Schedule A Participant) or three years (in the case of a Schedule B Participant) after the Date of Termination and (B) retired on the last day of such period.

5.5 Nonqualified Pension Benefit. The Participant shall be paid, in a lump sum payment in cash, an amount equal to the excess of:

(a) The actuarial equivalent of the benefit under the Company's applicable Retirement Plan (utilizing the rate used to determine lump sums and, to the extent applicable, other actuarial assumptions no less favorable to the Participant than those in effect under the Retirement Plan immediately prior to the Effective Date), any benefit under the Nonqualified Plan and, to the extent applicable, any other defined benefit retirement arrangement between the Participant and the Company ("Other Pension Benefits") which the Participant would receive if the Participant's employment continued for two or three additional years (for Schedule A Participants and Schedule B Participants, respectively) beyond the Date of Termination and, assuming that the Participant's compensation for such deemed additional period was the Participant's Annual Base Salary as in effect immediately prior to the Date of Termination and assuming a bonus in each year during such deemed additional period equal to the Target Bonus, over

(b) The actuarial equivalent of the Participant's actual benefit (paid or payable), if any, under the Retirement Plan, the Nonqualified Plan and Other Pension Benefits as of the Date of Termination (utilizing the rate used to determine lump sums and, to the extent applicable, other actuarial assumptions no less favorable to the Participant than those in effect under the Retirement Plan immediately prior to the effective date of the Change in Control).

5.6 Deferred Compensation. Any compensation previously deferred (other than pursuant to a tax-qualified plan) by or on behalf of the Participant (together with any accrued interest or earnings thereon), whether or not then vested, shall become vested on the Date of

Termination and shall be paid in accordance with the terms of the applicable deferred compensation plan, policy or practice under which it was deferred to the extent permitted by Section 409A of the Code.

5.7 Outplacement Services. The Company shall, at its sole expense as incurred, provide the Participant with outplacement services suitable to the Participant's position for a period not to exceed one year following the Date of Termination with a nationally recognized outplacement firm.

5.8 Other Benefits. To the extent not theretofore paid or provided, the Company shall pay or provide to the Participant any other amounts or benefits required to be paid or provided or which the Participant is entitled to receive under any plan, program, policy, practice, contract or agreement of the Company (or other Employer), including earned but unpaid stock and similar compensation, but excluding medical or dental benefits if the Participant is eligible for such benefits to be provided by a subsequent employer, and benefits payable under any severance plan or policy (such other amounts and benefits that are payable to the Participant shall be hereinafter referred to as the "Other Benefits").

5.9 Termination By Participant For Good Reason as described in Subsection 2.17(d) Within Two Years After a Change in Control. Subject to Section 3.3 and Article V of the Plan, if, within two years following the occurrence of a Change in Control, a Participant shall voluntarily terminate his or her employment for Good Reason as described in Subsection 2.17(d):

(a) Severance Pay. The Participant shall receive a lump sum payment in accordance with Section 6.1 of the Plan based upon the amount of the Participant's base salary, the number of Years of Service completed as of the Participant's Termination Date, as indicated below:

(i) **Less than Thirteen Years of Service:** If, as of the Participant's Termination Date he or she has completed fewer than thirteen Years of Service, the amount of severance pay shall equal 26 weeks of base salary.

(ii) **Thirteen or More Years of Service:** If, as of the Participant's Termination Date, he or she has completed thirteen or more Years of Service, the amount of severance pay shall equal two weeks of base salary for each Year of Service, up to a maximum of 52 weeks of base salary.

(b) Annual Incentive Awards. A Participant shall receive a prorated annual incentive award pursuant to the performance incentive program, if applicable, for the calendar year in which the Participant's Termination of Employment occurs. The award shall be calculated based solely on 100 percent of the target incentive award and prorated based on the number of days of employment in the calendar year in which the participant's Termination of Employment occurs through the employee's Termination Date. Annual incentive awards with respect to the calendar year in which a Participant's Termination Date occurs will be paid at the same time as awards for such calendar year are paid to active employees of the Employer.

(c) Outplacement Services. Outplacement services approved by the Committee, which may include individual or group counseling and administrative assistance or workshops, shall be available beginning on the Participant's Date of Termination or such earlier date designated by the participant's business unit leadership. Outplacement services shall continue to be available for the period up to 12 months.

(d) Educational Assistance. Education assistance shall be provided in accordance with the Employer's tuition program.

(e) Health Care Benefits.

(i) Retiree Health Care Coverage. An Eligible Employee who has not otherwise satisfied the eligibility criteria for participation prior to his Date of Termination Date, shall be entitled to elect retiree coverage under the Employer's applicable retiree group health care plans as though he or she otherwise satisfied such plans' eligibility requirements if:

(A) The Participant has attained age 50 and completed ten or more Years of Service as of his or her Termination Date but the sum of the Participant's age and Years of Service is less than 80; or

(B) The Participant has attained age 49 and completed 20 or more Years of Service as of his or her Termination Date but the sum of the Participant's age and Years of Service is less than 80.

Such coverage shall commence no earlier than the Participant's Termination Date. The Participant shall be charged the full cost of retiree coverage under these plans.

(ii) COBRA Continuation Coverage. Each Participant who is not eligible for, or does not elect, the retiree health care coverage described in this subsection (e) shall be entitled, pursuant to any continuation coverage rights under COBRA to continue individual and dependent coverage under the Company's group health care plans following the Participant's Termination Date. If continuation coverage is elected, the Employer shall pay the same portion of the cost of medical coverage that it paid immediately prior to the Participant's Date of Termination for active employees during the period that the Participant would have received severance pay if severance pay had been paid in bi-weekly installments, and the Participant shall pay the balance. The Participant shall be charged the full expense of medical coverage (102 percent of the cost of coverage) during the remainder of the COBRA coverage period, if any, and the full expense of dental and (if applicable) vision and hearing coverage (102 percent of the cost of coverage) during the entire COBRA coverage period.

(f) Life Insurance. A Participant who is not eligible for coverage under the Employer's retiree life insurance plan shall be entitled, during the period that the Participant would have received severance pay if severance pay had been paid in bi-weekly installments, to life insurance coverage at the Employer's expense in an amount equal to the group term life insurance coverage in effect for such Participant under the Employer's group term life insurance plan for active employees as of his Date of Termination.

(g) Other Benefits. A Participant shall not be entitled to any severance, separation or early retirement incentive pay or benefits other than as provided under the Plan or under any qualified or nonqualified retirement plan or deferred compensation arrangement maintained by the Employer. Except as provided in the foregoing sentence, a Participant's rights under any other employee benefit plans maintained by the Company or an Affiliate shall be determined in accordance with the provisions of such plans, including the Company's right to amend or terminate such plans at any time.

5.10 Termination By Employer For Cause or By Participant Other Than For Good Reason. If, at any time after a Change in Control, either (a) an Employer shall terminate a Participant's employment for Cause or (b) the Participant shall voluntarily terminate his employment other than for Good Reason, the Employer shall have no further payment obligations to the Participant other than for the Participant's base salary through the Date of Termination and any accrued but unpaid vacation pay. In such case, all such amounts shall be paid to the Participant in a lump sum in accordance with Section 6.1 of the Plan.

5.1 Death. If a Participant's employment terminates by reason of the Participant's death after a Change in Control, all Accrued Obligations as of the time of death shall be paid to the Participant's estate or beneficiary, as applicable, in a lump sum in cash in accordance with Section 6.1 of the Plan. The Participant's estate or beneficiary shall be entitled to any Other Benefits in accordance with their terms. The treatment of Prior Equity Awards shall be governed by the terms of the Long-Term Incentive Plan and the related award agreements.

5.2 Disability. If a Participant's employment is terminated by reason of Disability after a Change in Control, all Accrued Obligations shall be paid to the Participant in a lump sum in cash in accordance with Section 6.1 of the Plan. The treatment of Prior Equity Awards shall be governed by the terms of the Long-Term Incentive Plan and the related award agreements.

5.3 Retirement. If a Participant's employment terminates as a result of Retirement after a Change in Control, the Participant shall be paid the Accrued Obligations in a lump sum in cash in accordance with Section 6.1 of the Plan and the Participant shall be entitled to any Other Benefits in accordance with their terms. The treatment of Prior Equity Awards shall be governed by the terms of the Long-Term Incentive Plan and the related award agreements.

ARTICLE VI

TIMING OF, LIMITATIONS ON AND ADJUSTMENTS TO PLAN PAYMENTS

6.1 Time of Payments. Payments under the Plan shall be made to the Participant as follows:

(a) With respect to benefits under Sections 4.2, 4.10(a), 5.2, 5.5, 5.9(a), 5.12 and 5.13 of the Plan, payment to a Participant who is not a Specified Employee shall be made within the 60-day period following the Participant's Date of Termination. With respect to benefits under Section 5.11 of the Plan, payment shall be made within the 60-day period following the Participant's date of the Participant's death. However, if the period to consider and revoke the written agreement required to receive the benefits described in Articles IV and V of the Plan (i.e., the waiver and release) spans two taxable years, in all events the payments will be made in second taxable year within 30 days following the later of the end of the first taxable year or the date the executed release is received by the Company.

(b) With respect to benefits under Sections 4.4, 4.10(b) and 5.9(b) of the Plan, payments shall be made to the Participants at the same time the payments are made to active employees.

(c) Notwithstanding anything to the contrary in the Plan, to the extent necessary to comply with Section 409A of the Code, payments to a Participant who is a Specified Employee shall be made within the 60-day period following the six-month anniversary of the Participant's Date of Termination (other than by reason of death).

(d) All payments under the Plan that are reimbursements of covered expenses incurred by the Participant shall be made within the taxable year in which the expense is incurred.

6.2 Payment Offsets. Notwithstanding anything in the Plan to the contrary, in the event a Participant is entitled to receive severance payments both under this Plan and under the terms of either (a) an individual change of control or employment agreement, (b) another severance pay plan or policy of an Employer or (c) any existing or future law or regulation, the benefits payable under this Plan shall be reduced by the amount of any severance benefits such Participant is entitled to receive under such individual agreement, plan, policy, law or regulation.

6.3 Cap on Excess Parachute Payments; Gross-Up Payments . Notwithstanding anything in the Plan to the contrary, if (a) a Participant is a "disqualified individual" (as defined in Section 280G(c) of the Code) and (b) the severance benefits provided under Articles IV or V, as applicable, together with any other payments the Participant has the right to receive from an Employer, would constitute a "parachute payment" (as defined in Section 280G(b) of the Code) ("Parachute Payments"), the following provisions shall apply:

(a) The severance benefits under Articles IV or V shall not exceed an amount which, together with any other Parachute Payments the Participant has a right to receive from the Employer, would be 2.99 times the Participant's "base amount" (as defined in Section 280G of the Code) so that no portion of the amounts received by the Participant shall be subject to the excise tax imposed under Section 4999 of the Code.

(b) The determination of whether any limitation on the severance benefits payable under Articles IV or V is necessary shall be made by the Company's independent auditor or such other certified public accounting firm as may be jointly designated by the Participant and the Company (the "Accounting Firm"), which shall provide detailed supporting calculations to the Participant and the Company. The determinations of the Accounting Firm shall be conclusive and binding on the Company and the Participant. All fees and expenses of the Accounting Firm shall be borne solely by the Company.

(c) If through error or otherwise, a Participant shall receive payments under the Plan, together with other Parachute Payments the Participant has the right to receive from an Employer, in excess of 2.99 times his base amount, the Participant shall immediately repay the excess to the Employer upon notification from the Employer that an overpayment has been made. If the Participant fails to repay the excess to the Employer within 10 business days of the date of the Employer's notification, the Participant will become liable to the Employer for an amount equal to two (2) times the excess amount.

6.4 Compliance with Section 409A of the Code. Notwithstanding anything in the Plan to the contrary, all Plan benefit obligations and payments are subject to Section 409A of the Code. To the extent required, the Company may modify the severance benefits payable hereunder to comply with Section 409A of the Code; provided, however, that the present value of the aggregate Plan benefits payable to a Participant after such modification shall not be less than the present value of the Plan benefits payable to the Participant prior to the modification.

6.5 Tax Withholding. Notwithstanding any other provision of this Plan, the Company may withhold from any amounts payable under this Plan such Federal, state, local, employment or foreign taxes as shall be required to be withheld pursuant to any applicable law or regulation.

ARTICLE VII
RESTRICTIVE COVENANTS

7.1 Confidentiality. As a condition to participation in the Plan, each Participant agrees to hold in a fiduciary capacity for the benefit of the Company and its Affiliates all Confidential Information which shall have been obtained by the Participant during the Participant's employment by the Employer; except, however, that this Section 7.1 shall not apply to Confidential Information that is or becomes public knowledge, unless such Confidential Information became or becomes public knowledge due to acts of the Participant or representatives of the Participant in violation of this Section 7.1. Upon termination of the Participant's employment, he shall return to the Company all Confidential Information in his possession. After termination of the Participant's employment with the Employer, the Participant shall not, without the prior written consent of the Company or as may otherwise be required by law or legal process, communicate or divulge any such Confidential Information to anyone other than the Company and those designated by it, except (a) otherwise publicly available information, (b) as may be necessary to enforce his rights under the Plan or as necessary to defend himself against a claim asserted directly or indirectly by the Company or its Affiliates or (c) as may be compelled by service of a valid subpoena or other legal process. If the Participant is served with a valid subpoena or other legal process, he must so notify the Company within three business days. Unless and until a determination has been made in accordance with Section 7.4 that the Participant has violated this Section 7.1, an asserted violation of the provisions of this Section 7.1 shall not constitute a basis for deferring or withholding any amounts otherwise payable to the Participant under the Plan.

7.2 Non-Compete. As a condition to participation in the Plan, each Participant agrees, that, in the event the Participant voluntarily terminates his employment other than for Good Reason, for the period of one year from Date of Termination he will not, without the written consent of the Company, directly or indirectly own, manage, operate, join, control, become employed by, consult to or participate in the ownership, management, or control of any business which is in direct competition with the Company or its Affiliates.

7.3 Non-Solicitation. As a condition to participation in the Plan, each Participant agrees that, in the event the Participant voluntarily terminates his employment other than for Good Reason, for the period of one year following the Date of Termination, he will not, directly or indirectly, solicit or hire, or encourage the solicitation or hiring by any employer other than the Company or its Affiliates, for any position as an employee, independent contractor, consultant or otherwise, any person who was a managerial or higher level employee of an Employer at any time during the term of the Participant's employment by the Employer; provided, however, that this provision shall not apply with respect to the solicitation of any person after six months from the date on which such person's employment by an Employer has terminated.

7.4 Enforcement. In the event of a breach by the Participant of any of the covenants set forth in this Article VII, it is agreed that the Company shall suffer irreparable harm for which money damages are not an adequate remedy, and that, in the event of such breach, the Company shall be entitled to obtain an order of a court of competent jurisdiction for equitable relief from such breach, including, but not limited to, temporary restraining orders and preliminary and/or permanent injunctions against the breach of such covenants by the Participant. In the event that the Company should initiate any legal action for the breach or enforcement of any of the provisions contained in this Article VII and the Company does not prevail in such action, the Company shall promptly reimburse the Participant the full amount of any court costs, filing fees, attorney's fees which the Participant incurs in defending such action, and any loss of income during the period of such litigation.

ARTICLE VIII
AMENDMENT AND TERMINATION

8.1 Amendment. The Company may amend this Plan at any time, and from time to time, by action of the Committee; provided, however, that no amendment adopted after the effective date of a Change in Control shall have the effect of either (a) removing an individual from the list of Participants, (b) adding conditions for participation or the entitlement to receive benefits hereunder, (c) reducing the amount of benefits payable to a Participant or (d) otherwise restricting a Participant's right to receive benefits under the Plan, except as may otherwise be required to conform such payments to the requirements of Section 409A of the Code, as provided in Section 1.1.

8.2 Termination. The Committee may terminate the Plan at any time prior to a Change in Control. The Plan may not be terminated after the effective date of a Change in Control.

ARTICLE IX

ADMINISTRATION

9.1 Plan Administrator. The Plan shall be administered by the Committee, which shall have the duties and responsibilities for administering the Plan as are specifically set forth in this Article IX.

9.2 Responsibilities of Committee.

(a) The Committee shall have responsibility for the day to day administration of the Plan. In addition, the Committee shall have the specific powers, duties, responsibilities and obligations specifically provided for herein.

(b) Subject to the express provisions of the Plan, the Committee shall have full and exclusive authority to interpret the Plan and to make all other factual determinations deemed necessary or advisable in the implementation and administration of the Plan, including but not limited to determinations with respect to the eligibility of Participants to receive benefits under the Plan and the status and rights of such Participants and all other persons affected hereunder. The Committee's interpretation and construction of the Plan shall be conclusive and binding on all persons.

(c) The Committee shall have sole authority to adopt rules and regulations, which shall be administered by the Committee. In addition, the Committee shall have the discretionary authority to issue rulings and interpretations concerning the Plan and all matters arising thereunder, on a uniform and nondiscriminatory basis, provided the same shall not be contrary to or inconsistent with any provision of the Plan.

(d) As a condition of distributing any benefit under the Plan, the Committee may prescribe the use of such forms and require the furnishing of such information as the Committee may deem appropriate for administering the Plan.

9.3 Allocation or Delegation of Duties and Responsibilities. In furtherance of its duties and responsibilities under the Plan, the Committee may:

(a) Employ agents to carry out non-fiduciary responsibilities;

(b) Employ agents to carry out fiduciary responsibilities;

(c) Consult with counsel, who may be counsel to the Company; and

(d) Delegate any of its duties and responsibilities hereunder to such officer or officers of the Company as the Committee shall designate; except, however, that the Committee may not delegate to any other person the designation of Eligible Employees under Section 3.1 or the authority to consider and determine appeals of alleged adverse benefit determinations.

9.4 Expenses. Unless otherwise agreed to by the Company, no person acting as a fiduciary hereunder (who is an employee of an Employer) shall receive any compensation for services as such. Expenses incurred by fiduciaries in connection with the administration of the Plan shall be paid by the Company.

9.5 Indemnification of Plan Administrator. The Company shall indemnify, to the fullest extent permitted by law, each person made or threatened to be made a party to any civil or criminal action or proceeding by reason of the fact that he, or his testator or intestate, was a member of the Committee, or a delegate of the Committee, acting in the capacity of Plan administrator.

9.6 Reliance Upon Others. The Committee, any person to whom it may delegate such of its duties and powers as provided herein, and the officers and directors of the Company shall be entitled to rely conclusively upon and shall be fully protected in any action taken by them in good faith in reliance upon any tables, valuations, certificates, opinions, reports or other advice furnished to them by any duly appointed actuary, accountant, legal counsel (who may be counsel for the Company) or other specialist.

9.7 Notification. All notices, reports and statements in connection with the Plan that are given, made, delivered or transmitted to a Participant shall be deemed duly given, made, delivered, or transmitted when mailed, by such class as the sender may deem appropriate, with postage prepaid and addressed to the Participant at the address last appearing on the records of the Employer with respect to this Plan. All notices, direct actions or other communications given, made, delivered or transmitted by a Participant to an Employer or Committee shall not be deemed to have been duly given, made, delivered, transmitted or received unless and until actually received by the Employer or Committee.

9.8 Multiple Capacities. A person may serve in more than one fiduciary capacity with respect to the Plan.

ARTICLE X
CLAIMS PROCEDURE

10.1 Submission of Claims. The initial claim by any Participant for benefits under this Plan shall be submitted in writing to the Committee (or its delegate) within 60 days after the occurrence of the termination of employment that the Participant claims to have triggered entitlement to Plan benefits.

10.2 Computation and Review of Claims. All benefits shall be computed by the Committee or its delegate. All claims shall be approved or denied by the Committee (or its delegate) as soon as practicable, but in no event later than 90 days after application by the

Participant. The Committee may take an additional 90 days to review the claim, provided that the Participant is notified in writing within the initial 90-day period.

(a) Initial Denial of Claim - Any denial of a claim shall include:

(i) Reason or reasons for the denial;

(ii) Reference to pertinent Plan provisions on which the denial is based;

(iii) Description of any additional material or information necessary for the Participant to perfect the claim together with an explanation of why the material or information is necessary; and

(iv) Explanation of the Plan's claim review procedure, described below.

(b) Review of a Denied Claim - A Participant shall have a reasonable opportunity to appeal a denied claim to the Committee (or its delegate) for a full and fair review. The Participant or a duly authorized representative:

(i) Shall have 60 days, after receipt of written notification of the denial of claim in which to request a review.

(ii) May request a review upon written application to the Committee.

(iii) Shall submit written comments, documents, records and other information relating to the claim.

(iv) May review, free of charge, pertinent Plan documents, records and other information relevant to the claim.

(c) Committee Review - The Committee's (or its delegate's) review shall take into account all comments, documents, records and other information submitted by the Participant relating to the claim, without regard to whether such information was submitted or considered in the initial benefit determination.

(d) Written Decision - The Committee (or its delegate) shall issue a decision on the reviewed claim promptly but no later than 60 days after receipt of the review. The Committee may take an additional 60 days to review the claim, provided that the Participant is notified in writing within the initial 60-day period. The Committee's decision shall be in writing and shall include:

(i) Reasons for the decision;

(ii) References to the Plan provisions on which the decision is based;

(iii) Statement that the Participant is entitled to receive, upon request, reasonable access to, and copies of, all documents, records and other information relevant to the claim; and

(iv) Statement that the Participant is entitled to bring a civil suit under Section 502(a) of ERISA.

(e) Binding Effect - The Committee's (or its delegate's) decision shall be final and binding on the Participant and the Employer.

ARTICLE XI
GENERAL PROVISIONS

11.1 Construction. This Plan shall be construed and enforced in accordance with and governed by the internal substantive laws (and not the laws relating to conflict of laws or choice of laws) of the State of New Jersey, except to the extent that such laws are preempted by Federal law.

11.2 Unfunded Plan. The obligations of the Company under this Plan are not required to be funded in advance. Nothing contained in this Plan shall give an Eligible Employee or Participant any right, title or interest in any property of the Company or any of its Affiliates.

11.3 No Right to Continued Employment. Nothing contained herein shall be deemed to give any Eligible Employee or Participant the right to be retained in the employment of an Employer or to limit the rights of any Employer to discharge any Eligible Employee or Participant at any time, with or without notice and with or without Cause.

11.4 Partial Invalidity. The invalidity or unenforceability of any term or provision, or any clause, or portion thereof, of this Plan shall in no way impair or affect the validity or enforceability of any other provision of this Plan, which shall remain in full force and effect.

11.5 Successors and Assigns.

(a) This Plan shall inure to the benefit of and be binding upon the Company and its successors and assigns.

(b) The Company shall require any successor (whether direct or indirect, by purchase, merger, consolidation or otherwise) to all or substantially all of the business and/or assets of the Company to assume expressly and agree to perform the Company's obligations under the Plan in the same manner and to the same extent that the Company would be required to perform it if no such succession had taken place.

(c) In no event shall a Participant assign his interests under the Plan to any other person without the prior written consent of the Committee.

11.6 Waivers. Failure to strictly comply with any term, condition or requirement set forth in the Plan shall not be deemed a waiver of such term, condition or requirement, nor shall any waiver of any such term, condition or requirement at any one time or times be deemed to result in a waiver of such term, condition or requirement at any other time or times.

11.7 Gender and Number. Masculine pronouns include the feminine as well as the neuter genders, and the singular shall include the plural, unless indicated otherwise by the context.

11.8 Headings. The headings of the Plan are for purposes of reference only and shall not limit or otherwise affect the meaning hereof.

* * *

Signature Date

SCHEDULE A
As Amended as of December 17, 2012
PARTICIPANTS

NAME	TITLE	PARTICPATION DATE
Stuart J. Black	VP and Assistant Controller (Power)	03/01/10
Robert C. Braun	SVP & Chief Operating Officer, PSEG Nuclear	12/4/09
Jorge L. Cardenas	VP – Asset Management and Centralized Services, PSE&G	1/23/07
Rose M. Chernick	VP – Finance (PSE&G)	8/09/10
John Paul Cowan	SVP – Operations, PSEG Fossil	09/15/09
Lathrop B. Craig	VP – Risk Management & Chief Risk Officer	09/05/11
David M. Daly	VP – LIPA Transition	1/28/08
Raymond V. DePillo	VP – Power Operations and Asset Mgmt, PSEG ER&T	03/20/07
Derek DiRisio	VP & Controller	12/20/04
Diana L. Drysdale	VP – Renewables, PSEG Energy Holdings	02/15/10
Kathleen Fitzgerald	VP – Corporate Communications	01/03/12
Joseph A. Forline	VP – Customer Solutions, PSE&G	12/19/06
Carl J. Fricker	VP – Salem, PSEG Nuclear	12/14/09
Robert F. Friend	VP – Procurement	04/20/10
Kim C. Hanemann	VP – Delivery Projects and Construction	12/21/10
Anne E. Hoskins	SVP – Public Affairs and Sustainability	04/05/07
Bradford D. Huntington	VP & Treasurer	04/16/11
Scott Jennings	President – PSEG Global and VP – Mergers & Acquisitions	10/18/05
Thomas P. Joyce	President & CNO, PSEG Nuclear	01/01/07
Robert C. Krueger, Jr	VP & Assistant Controller – Tax	12/19/06
Kathleen A. Lally	VP – Investor Relations	01/16/07
John R. Latka	VP – Electric Operations, PSE&G	10/23/06
Shawn P. Leyden	VP – Commercial	12/20/04
Tamara L. Linde	VP – Regulatory	12/19/06
Richard P. Lopriore	President, PSEG Fossil	06/19/07
Kristen M. Ludecke	VP – Federal Affairs	02/22/10
Shahid Malik	President – Energy Resources & Trade (ER&T0	12/5/11
NAME	**TITLE**	**PARTICPATION DATE**
Patricia R. McLaughlin	VP – Internal Auditing Services	03/01/10
Michael S. Paszynsky	VP – Business Assurance and Resilience	03/01/10
Margaret M. Pego	SVP – Human Resources & CHRO	12/20/04
John F. Perry	VP – Hope Creek, PSEG Nuclear	09/15/09

Kevin J. Quinn	VP – Finance (Energy Holdings) and Corp. Planning & Analysis	03/01/10
Sheila J. Rostiac	VP – Talent, Development and Diversity	08/20/12
Joseph Santamaria	VP – Information Technology & CIO	10/29/12
John P. Scarlata	– Gas Supply, PSEG ER&T	4/20/10
Richard T. Thigpen	VP - – State Governmental Affairs	3/26/07
John F. Tiberi	VP – Employee Benefits, Health & Safety	07/09/12

SCHEDULE B
As Amended as of December 17, 2012
PARTICIPANTS

NAME	TITLE	PARTICPATION DATE
Ralph Izzo	Chairman of the Board, President and CEO	12/15/08
J. A. Bouknight, Jr.	EVP and General Counsel	11/02/09
Caroline Dorsa	EVP and CFO	04/09/09
Ralph A. LaRossa	President – Public Service Electric and Gas Company	10/17/06
William Levis	President – PSEG Power LLC	01/01/07
Randall E. Mehrberg	EVP Strategy & Development, & President, PSEG Energy Holdings L.L.C.	09/22/08

EXHIBIT I

Form of Restrictive Covenant Agreement

AGREEMENT, by and between Public Service Enterprise Group Incorporated, a New Jersey Corporation (the "Company") and [_________________] ("Executive"), dated as of [______________].

WHEREAS, the Company maintains the Key Executive Severance Plan of Public Service Enterprise Group Incorporated (the "Plan"), effective December 17, 2012, and as thereafter amended, modified or supplemented;

WHEREAS, Executive was designated as an Eligible Employee under the Plan by the Organization and Compensation Committee of the Company's Board of Directors;

WHEREAS, pursuant to Section 3.2 of the Plan, in order to be a Participant in and be entitled to benefits and protections under the Plan, Executive must execute and delivery to the Company within 30 days after Executive was designated as an Eligible Employee a written agreement to be bound by the terms and conditions of certain covenants set out in Article VII of the Plan, which is hereby incorporated herein;

NOW THEREFORE, the parties agree as follows:

1. Executive has received a copy of the Plan and has read and understands the terms of conditions of Section 7.1, Confidentiality, Section 7.2, Non-Compete, and Section 7.3, Non-Solicitation, therein, as applied to Executive (the "Covenants").

2. Executive agrees to be bound by and comply with the terms of the Covenants in consideration for becoming a Participant in the Plan.

3. Executive acknowledges that the Covenants are reasonable in the scope of the activities restricted, the geographic area covered by the restrictions, the duration of the restrictions, and that such Covenants are reasonably necessary to protect the Company's legitimate interests in its Confidential Information and its relationships with its employees, customers and suppliers.

4. Executive acknowledges that the Covenants will not deprive Executive of the ability to earn a livelihood or to support Executive's dependents.

5. Executive shall be a Participant in the Plan and be entitled to all of the rights and benefits provided thereunder as of the date of this Agreement.

6. This Agreement shall be construed and enforced in accordance with and governed by the internal substantive laws (and not the laws relating to conflict of laws or choice of laws) of the State of New Jersey, except to the extent that such laws are preempted by Federal law.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date and year first above written.

[This Agreement may be executed in counterparts.]

EXECUTIVE

PUBLIC SERVICE ENTERPRISE
GROUP INCORPORATED

By:___________________________

Title:_________________________

EXHIBIT 12

PUBLIC SERVICE ENTERPRISE GROUP INCORPORATED
COMPUTATION OF RATIOS OF EARNINGS TO FIXED CHARGES

	Years Ended December 31, 2012	2011	2010	2009	2008
Earnings as Defined in Regulation S-K (A):					
Pre-tax Income from Continuing Operations	$ 2,011	$ 2,384	$ 2,616	$ 2,636	$ 1,806
(Income) Loss from Equity Investees, net of Distributions	9	(4)	(19)	(25)	(5)
Fixed Charges	479	522	571	600	633
Capitalized Interest	(19)	(14)	(67)	(45)	(37)
Preferred Securities Dividend Requirements of Subsidiaries	—	—	(2)	(6)	(6)
Total Earnings	$ 2,480	$ 2,888	$ 3,099	$ 3,160	$ 2,391
Fixed Charges as Defined in Regulation S-K (B)					
Interest Expense	$ 465	$ 509	$ 555	$ 581	$ 615
Interest Factor in Rentals	14	13	14	13	12
Preferred Securities Dividend Requirements of Subsidiaries	—	—	2	6	6
Total Fixed Charges	$ 479	$ 522	$ 571	$ 600	$ 633
Ratio of Earnings to Fixed Charges	5.18	5.53	5.43	5.27	3.78

(A) The term “earnings” shall be defined as pre-tax Income from Continuing Operations before income or loss from equity investees plus distributed income from equity investees. Add to pre-tax income the amount of fixed charges adjusted to exclude (a) the amount of any interest capitalized during the period and (b) the actual amount of any preferred securities dividend requirements of majority-owned subsidiaries stated on a pre-tax level.

(B) Fixed Charges represent (a) interest, whether expensed or capitalized, (b) amortization of debt discount, premium and expense, (c) an estimate of interest implicit in rentals and (d) preferred securities dividend requirements of majority-owned subsidiaries stated on a pre-tax level.

EXHIBIT 12a

PSEG POWER LLC
COMPUTATION OF RATIOS OF EARNINGS TO FIXED CHARGES

	Years Ended December 31,				
	2012	2011	2010	2009	2008
Earnings as Defined in Regulation S-K (A):					
Pre-tax Income from Continuing Operations	$ 1,080	$ 1,687	$ 1,914	$ 1,958	$ 1,711
Fixed Charges	163	208	238	221	210
Capitalized Interest	(4)	(10)	(62)	(43)	(31)
Total Earnings	$ 1,239	$ 1,885	$ 2,090	$ 2,136	$ 1,890
Fixed Charges as Defined in Regulation S-K (B)					
Interest Expense	$ 161	$ 205	$ 235	$ 219	$ 208
Interest Factor in Rentals	2	3	3	2	2
Total Fixed Charges	$ 163	$ 208	$ 238	$ 221	$ 210
Ratio of Earnings to Fixed Charges	7.60	9.06	8.78	9.67	9.00

(A) The term "earnings" shall be defined as pre-tax Income from Continuing Operations. Add to pre-tax income the amount of fixed charges adjusted to exclude the amount of any interest capitalized during the period.

(B) Fixed Charges represent (a) interest, whether expensed or capitalized, (b) amortization of debt discount, premium and expense and (c) an estimate of interest implicit in rentals.

EXHIBIT 12b

PUBLIC SERVICE ELECTRIC AND GAS COMPANY
COMPUTATION OF RATIOS OF EARNINGS TO FIXED CHARGES

	Years Ended December 31, 2012	2011	2010	2009	2008
Earnings as Defined in Regulation S-K (A):					
Pre-tax Income from Continuing Operations	$ 835	$ 861	$ 591	$ 551	$ 592
Fixed Charges	314	319	325	317	325
Capitalized Interest	(13)	(4)	(2)	(1)	—
Total Earnings	$ 1,136	$ 1,176	$ 914	$ 867	$ 917
Fixed Charges as Defined in Regulation S-K (B)					
Interest Expense	$ 308	$ 314	$ 320	$ 313	$ 325
Interest Factor in Rentals	6	5	5	4	—
Total Fixed Charges	$ 314	$ 319	$ 325	$ 317	$ 325
Ratio of Earnings to Fixed Charges	3.62	3.69	2.81	2.74	2.82

(A) The term "earnings" shall be defined as pretax income from continuing operations. Add to pretax income the amount of fixed charges adjusted to exclude the amount of any interest capitalized during the period.

(B) Fixed Charges represent (a) interest, whether expensed or capitalized, (b) amortization of debt discount, premium and expense and (c) an estimate of interest implicit in rentals.

EXHIBIT 12c

PUBLIC SERVICE ELECTRIC AND GAS COMPANY
COMPUTATION OF RATIOS OF EARNINGS TO FIXED CHARGES
Plus Preferred Security Dividend Requirements

	Years Ended December 31,				
	2012	2011	2010	2009	2008
Earnings as Defined in Regulation S-K (A):					
Pre-tax Income from Continuing Operations	$ 835	$ 861	$ 591	$ 551	$ 592
Fixed Charges	314	319	327	323	332
Capitalized Interest	(13)	(4)	(2)	(1)	—
Preferred Securities Dividend Requirements	—	—	(2)	(6)	(6)
Total Earnings	$ 1,136	$ 1,176	$ 914	$ 867	$ 918
Fixed Charges as Defined in Regulation S-K (B)					
Interest Expense	$ 308	$ 314	$ 320	$ 313	$ 325
Interest Factor in Rentals	6	5	5	4	—
Preferred Securities Dividend	—	—	1	4	4
Adjustments to state Preferred Securities Dividends on a pre-income tax basis	—	—	1	2	2
Total Fixed Charges	$ 314	$ 319	$ 327	$ 323	$ 331
Ratio of Earnings to Fixed Charges	3.62	3.69	2.80	2.68	2.77

(A) The term "earnings" shall be defined as pretax income from continuing operations. Add to pretax income the amount of fixed charges adjusted to exclude (a) the amount of any interest capitalized during the period (b) the actual amount of any preferred securities dividend requirements of majority owned subsidiaries (c) preferred stock dividends which were included in such fixed charges amount but not deducted in the determination of pre-tax income.

(B) Fixed Charges represent (a) interest, whether expensed or capitalized, (b) amortization of debt discount and premium expense (c) an estimate of interest implicit in rentals and (d) preferred securities dividend requirements of majority owned subsidiaries and preferred stock dividends, increased to reflect the pre-tax earnings requirement for PSE&G.

EXHIBIT 21

PUBLIC SERVICES ENTERPRISE GROUP INCORPORATED
SIGNIFICANT SUBSIDIARIES

Name	Ownership %	State of Incorporation
Public Service Electric and Gas Company	100	New Jersey
PSEG Power LLC	100	Delaware
PSEG Fossil LLC	100	Delaware
PSEG Nuclear LLC	100	Delaware
PSEG Energy Resources & Trade LLC	100	Delaware

The remaining subsidiaries of Public Service Enterprise Group Incorporated are not significant as defined in Regulation S-X.

Exhibit 23

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in Registration Statement Nos. 333-120100, 333-106330, 033-44581 and 033-44582 on Form S-8 and Registration Statement No. 333-178143 on Form S-3 of our report dated February 25, 2013, relating to the consolidated financial statements and consolidated financial statement schedule of Public Service Enterprise Group Incorporated and subsidiaries (the “Company”) as of and for the year ended December 31, 2012, and our report dated February 25, 2013 relating to the effectiveness of the Company's internal control over financial reporting as of December 31, 2012, appearing in this Annual Report on Form 10-K of Public Service Enterprise Group Incorporated for the year ended December 31, 2012.

/s/Deloitte & Touche LLP
Parsippany, New Jersey
February 25, 2013

Exhibit 23a

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in Registration Statement No. 333-175397 on Form S-3 of our report dated February 25, 2013, relating to the consolidated financial statements and consolidated financial statement schedule of PSEG Power LLC and subsidiaries, appearing in this Annual Report on Form 10-K of PSEG Power LLC for the year ended December 31, 2012.

/s/Deloitte & Touche LLP
Parsippany, New Jersey
February 25, 2013

Exhibit 23b

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in Registration Statement No. 333-178133 on Form S-3 of our report dated February 25, 2013, relating to the consolidated financial statements and consolidated financial statement schedule of Public Service Electric and Gas Company and subsidiaries, appearing in this Annual Report on Form 10-K of Public Service Electric and Gas Company for the year ended December 31, 2012.

/s/Deloitte & Touche LLP
Parsippany, New Jersey
February 25, 2013

EXHIBIT 31

Certification Pursuant to Rules 13a-14 and 15d-14
of the 1934 Securities Exchange Act

I, Ralph Izzo, certify that:

1. I have reviewed this Annual Report on Form 10-K of Public Service Enterprise Group Incorporated;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 25, 2013

/s/ Ralph Izzo

Ralph Izzo
Public Service Enterprise Group Incorporated
Chief Executive Officer

EXHIBIT 31a

Certification Pursuant to Rules 13a-14 and 15d-14
of the 1934 Securities Exchange Act

I, Caroline Dorsa, certify that:

1. I have reviewed this Annual Report on Form 10-K of Public Service Enterprise Group Incorporated;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 25, 2013

/s/ Caroline Dorsa

Caroline Dorsa
Public Service Enterprise Group Incorporated
Chief Financial Officer

EXHIBIT 31b

Certification Pursuant to Rules 13a-14 and 15d-14
of the 1934 Securities Exchange Act

I, Ralph Izzo, certify that:

1. I have reviewed this Annual Report on Form 10-K of PSEG Power LLC;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 25, 2013

/s/ Ralph Izzo

Ralph Izzo
PSEG Power LLC
Chief Executive Officer

EXHIBIT 31c

Certification Pursuant to Rules 13a-14 and 15d-14
of the 1934 Securities Exchange Act

I, Caroline Dorsa, certify that:

1. I have reviewed this Annual Report on Form 10-K of PSEG Power LLC;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 25, 2013

/s/ Caroline Dorsa

Caroline Dorsa
PSEG Power LLC
Chief Financial Officer

EXHIBIT 31d

Certification Pursuant to Rules 13a-14 and 15d-14
of the 1934 Securities Exchange Act

I, Ralph Izzo, certify that:

1. I have reviewed this Annual Report on Form 10-K of Public Service Electric and Gas Company;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 25, 2013

/s/ Ralph Izzo

Ralph Izzo

Public Service Electric and Gas Company
Chief Executive Officer

EXHIBIT 31e

Certification Pursuant to Rules 13a-14 and 15d-14
of the 1934 Securities Exchange Act

I, Caroline Dorsa, certify that:

1. I have reviewed this Annual Report on Form 10-K of Public Service Electric and Gas Company;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 25, 2013

/s/ Caroline Dorsa

Caroline Dorsa

Public Service Electric and Gas Company
Chief Financial Officer

EXHIBIT 32

**Certification Pursuant to Section 1350 of Chapter 63 of Title 18
of the United States Code**

I, Ralph Izzo, Chief Executive Officer of Public Service Enterprise Group Incorporated, to the best of my knowledge, certify that (i) the Annual Report of Public Service Enterprise Group Incorporated on Form 10-K for the year ended December 31, 2012 (the “Report”) fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and (ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Public Service Enterprise Group Incorporated.

/s/ Ralph Izzo

Ralph Izzo
Public Service Enterprise Group Incorporated
Chief Executive Officer
February 25, 2013

EXHIBIT 32a

**Certification Pursuant to Section 1350 of Chapter 63 of Title 18
of the United States Code**

I, Caroline Dorsa, Chief Financial Officer of Public Service Enterprise Group Incorporated, to the best of my knowledge, certify that (i) the Annual Report of Public Service Enterprise Group Incorporated on Form 10-K for the year ended December 31, 2012 (the "Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and (ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Public Service Enterprise Group Incorporated.

/s/ Carolina Dorsa

Carolina Dorsa
Public Service Enterprise Group Incorporated
Chief Financial Officer
February 25, 2013

EXHIBIT 32b

Certification Pursuant to Section 1350 of Chapter 63 of Title 18
of the United States Code

I, Ralph Izzo, Chief Executive Officer of PSEG Power LLC, to the best of my knowledge, certify that (i) the Annual Report of PSEG Power LLC on Form 10-K for the year ended December 31, 2012 (the "Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and (ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of PSEG Power LLC.

/s/ Ralph Izzo

Ralph Izzo

PSEG Power LLC
Chief Executive Officer
February 25, 2013

EXHIBIT 32c

Certification Pursuant to Section 1350 of Chapter 63 of Title 18
of the United States Code

I, Caroline Dorsa, Chief Financial Officer of PSEG Power LLC, to the best of my knowledge, certify that (i) the Annual Report of PSEG Power LLC on Form 10-K for the year ended December 31, 2012 (the “Report”) fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and (ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of PSEG Power LLC.

/s/ Carolina Dorsa

Carolina Dorsa

PSEG Power LLC
Chief Financial Officer
February 25, 2013

EXHIBIT 32d

Certification Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code

I, Ralph Izzo, Chief Executive Officer of Public Service Electric and Gas Company, to the best of my knowledge, certify that (i) the Annual Report of Public Service Electric and Gas Company on Form 10-K for the year ended December 31, 2012 (the "Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and (ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Public Service Electric and Gas Company.

/s/ Ralph Izzo

Ralph Izzo

Public Service Electric and Gas Company
Chief Executive Officer
February 25, 2013

EXHIBIT 32e

Certification Pursuant to Section 1350 of Chapter 63 of Title 18
of the United States Code

I, Caroline Dorsa, Chief Financial Officer of Public Service Electric and Gas Company, to the best of my knowledge, certify that (i) the Annual Report of Public Service Electric and Gas Company on Form 10-K for the year ended December 31, 2012 (the "Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and (ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Public Service Electric and Gas Company.

/s/ Carolina Dorsa

Carolina Dorsa

Public Service Electric and Gas Company
Chief Financial Officer
February 25, 2013

EXHIBIT 21

PUBLIC SERVICES ENTERPRISE GROUP INCORPORATED
SIGNIFICANT SUBSIDIARIES

Name	Ownership %	State of Incorporation
Public Service Electric and Gas Company	100	New Jersey
PSEG Power LLC	100	Delaware
PSEG Fossil LLC	100	Delaware
PSEG Nuclear LLC	100	Delaware
PSEG Energy Resources & Trade LLC	100	Delaware

The remaining subsidiaries of Public Service Enterprise Group Incorporated are not significant as defined in Regulation S-X.

<u>DECLARATION OF JAMES A. RAKITSKY</u>

1. I am the Vice President of Environmental Services for named third party defendants Quality Carriers, Inc. and Quala Systems, Inc. I make this declaration in support of settlement of the current litigation pending in the Superior Court of New Jersey Law Division - Essex County, captioned *NJDEP v. Occidental Chemical Corp, et. al.,* No. ESX-L9868-05(PASR).

2. I have been employed by Quality Carriers, Inc. and Quala Systems, Inc. and their predecessors, affiliates and parent corporations since 1984. I refer herein to Quality Carriers, Inc. and Quala Systems, Inc. collectively as the "the Companies," but individually by name. The Companies were each named by the Third-Party Plaintiffs in Third Party Complaint B as dischargers from the Chemical Leaman Site (see Third-Party Complaint B ¶¶ 713-729.

3. I was initially employed by Chemical Leaman Tank Lines, Inc. ("CLTL"), the Companies' predecessor, in the Engineering and Environmental Services Department, starting as a staff engineer and eventually becoming Manager of Engineering and Environmental Services. I have held my current position of Vice President of Environmental Services for Quality Carriers, Inc. and Quala Systems, Inc. as well as their ultimate parent, Quality Distribution, Inc., since 2000.

4. I hold both a Bachelors and a Masters Degree in Chemical Engineering from Drexel University. During my years with Quality Carriers, Inc. and Quala Systems, Inc. and their respective predecessors, affiliates and parent corporations, my duties have primarily involved ensuring the Companies' compliance with environmental laws and regulations; oversight of environmental reporting and compliance issues related to the companies' transportation, tank washing and terminal operations; oversight of remediation of the Companies' former operating sites; and ISRA and New Jersey Spill Act investigations and compliance.

5. CLTL purchased the Chemical Leaman Site ("the Site") located at 80 Doremus Avenue in 1970. Based on historical research conducted in support of Quala Systems, Inc.'s filings under ISRA, the Site was formerly owned and operated by numerous industrial companies, including PSEG's predecessors, a predecessor of Chevron, and a bulk chemical transportation company.

6. Chemical Leaman Tank Lines, Inc. ("CLTL") operated a transportation and tank washing business on the Site beginning in 1970. Its corporate parent was Chemical Leaman Corporation. CLTL was a common carrier transportation company that operated tank truck terminals as well as associated tank washing operations. The tank washing operations were primarily used for washing CLTL's own tanks. In 1985, CLTL established the trade name "QualaWash" and marketed and promoted its tank cleaning services to outside customers. QualaWash was a division of CLTL.

7. During the summer of 1992, an internal business decision was made to separate the transportation and tank cleaning operations into two separate companies. All tank cleaning operations of QualaWash were moved into NuBulk Services, Inc., which was an existing subsidiary of Chemical Leaman Corporation, the parent of CLTL. All common carrier trucking operations, including those of NuBulk, were moved to and consolidated under CLTL. On September 4, 1992 the name of NuBulk Services was changed to Quala Systems, Inc. (*See* Ex. A, Delaware Secretary of State Certification.) Beginning on January 1, 1993, the names of NuBulk and CLTL were officially changed to Quala Systems, Inc. on all environmental and other permits and governmental filings. Quala Systems, Inc. is the successor of NuBulk Services and the tank cleaning operations of CLTL. Quality Carriers, Inc. was not in existence until 1999.

8. In 1998, MTL, Inc. (an unrelated company) purchased CLTL and Quala Systems, Inc. and their mutual parent, Chemical Leaman Corporation. In 1999 CLTL was merged into a subsidiary of MTL, Inc. called Montgomery Tank Lines, Inc. except for CLTL's limited common carrier waste hauling operations in New Jersey. MTL, Inc., which subsequently changed its name to Quality Distribution, Inc., became the parent of CLTL, Quala Systems, Inc., and Montgomery Tank Lines, Inc.

9. Montgomery Tank Lines, Inc. changed its name to Quality Carriers, Inc. in 1999. It was a direct subsidiary of Quality Distribution, Inc. Quala Systems, Inc. continued the tank cleaning operations it had inherited from CLTL and NuBulk and remained a subsidiary of Chemical Leaman Corporation, which was in return, a direct subsidiary of Quality Distribution. Quality Carriers, Inc. and Quala Systems, Inc. were sister affiliated companies, with Quality Carriers, Inc. conducting primarily the common carrier transportation operations and Quala Systems, Inc. just conducting the tank cleaning operations. By 2002, the limited CLTL common carrier New Jersey waste hauling operations had been moved into Quality Carriers, Inc. and CLTL was no longer in existence.

10. Quality Carriers, Inc. continued to conduct primarily common carrier trucking operations in North America, and owned the real property consisting of the Site because Quality Distribution, Inc. did not see a purpose in deeding the real property to Quala Systems, Inc., another affiliate. Quala Systems, Inc. continued to own and operate the truck washing operations on the Site.

11. Quala Systems, Inc. is the responsible party under ISRA for remediation of the Site. Quality Distribution, Inc. was added later as an ISRA responsible party because it was the financial guarantor of ISRA obligations. The State of New Jersey has not indicated that Quality

Carriers, Inc. is a responsible party under the Spill Act or ISRA for remediation of the Chemical Leaman Site.

12. Given my personal knowledge and observation of the corporate history and historic operations of CLTL, Quala Systems, Inc. and Quality Carriers, Inc. on the Site, Quality Carriers, Inc. has no liability as a discharger of hazardous substances into the Newark Bay Complex and is merely alleged to be liable in its capacity as a successor to CLTL and corporate affiliate of Quala Systems, Inc., Quality Carriers, Inc. should be treated as "vicariously liable" for purposes of this settlement pursuant to the definition in Paragraph 18.32 of the proposed Consent Judgment. Quala Systems, Inc. is the properly named defendant. CLTL is a dissolved corporation that is no longer in existence.

13. This declaration is submitted for settlement purposes only, and is not an admission of any liability of Quality Carriers, Quala Systems, their parents, affiliates, predecessors, officers or employees.

I declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge, based upon my review of available information and my personal knowledge.

3-13-13
Date

James A. Rakitsky
James A. Rakitsky

#12639638_v1

Exhibit A

Delaware

PAGE 1

The First State

I, HARRIET SMITH WINDSOR, SECRETARY OF STATE OF THE STATE OF DELAWARE, DO HEREBY CERTIFY THE ATTACHED ARE TRUE AND CORRECT COPIES OF ALL DOCUMENTS ON FILE OF "QUALA SYSTEMS, INC." AS RECEIVED AND FILED IN THIS OFFICE.

THE FOLLOWING DOCUMENTS HAVE BEEN CERTIFIED:

CERTIFICATE OF INCORPORATION, FILED THE ELEVENTH DAY OF FEBRUARY, A.D. 1985, AT 9 O'CLOCK A.M.

CERTIFICATE OF AMENDMENT, CHANGING ITS NAME FROM "NU-BULK TRUCKING CO., INC." TO "NUBULK SERVICES, INC.", FILED THE SEVENTH DAY OF MARCH, A.D. 1985, AT 9 O'CLOCK A.M.

CERTIFICATE OF OWNERSHIP, FILED THE TWENTY-EIGHTH DAY OF DECEMBER, A.D. 1987, AT 9 O'CLOCK A.M.

AND I DO HEREBY FURTHER CERTIFY THAT THE EFFECTIVE DATE OF THE AFORESAID CERTIFICATE OF OWNERSHIP IS THE FIRST DAY OF JANUARY, A.D. 1988.

CERTIFICATE OF AMENDMENT, CHANGING ITS NAME FROM "NUBULK SERVICES, INC." TO "QUALA SYSTEMS, INC.", FILED THE FOURTH DAY OF SEPTEMBER, A.D. 1992, AT 9 O'CLOCK A.M.

CERTIFICATE OF CHANGE OF REGISTERED AGENT, FILED THE FIFTEENTH DAY OF MARCH, A.D. 1993, AT 4:30 O'CLOCK P.M.

2054671 8100H

061111464

Harriet Smith Windsor

Harriet Smith Windsor, Secretary of State

AUTHENTICATION: 5344488

DATE: 01-10-07

Delaware

The First State

I, JEFFREY W. BULLOCK, SECRETARY OF STATE OF THE STATE OF DELAWARE DO HEREBY CERTIFY THAT THE ATTACHED IS A TRUE AND CORRECT COPY OF CERTIFICATE OF FORMATION OF "RECKITT BENCKISER LLC" FILED IN THIS OFFICE ON THE TWENTY-FIRST DAY OF DECEMBER, A.D. 2010, AT 5:12 O'CLOCK P.M.

AND I DO HEREBY FURTHER CERTIFY THAT THE EFFECTIVE DATE OF THE AFORESAID CERTIFICATE OF FORMATION IS THE THIRTY-FIRST DAY OF DECEMBER, A.D. 2010, AT 12 O'CLOCK A.M.

SECRETARY'S OFFICE
1793 DELAWARE 1855

Jeffrey W. Bullock, Secretary of State

0839519 8100V

101219142

AUTHENTICATION: 8452156

DATE: 12-23-10

State of Delaware
Secretary of State
Division of Corporations
Delivered 05:17 PM 12/21/2010
FILED 05:12 PM 12/21/2010
SRV 101219142 - 0839519 FILE

CERTIFICATE OF FORMATION

OF

RECKITT BENCKISER LLC

This Certificate of Formation of Reckitt Benckiser LLC is being duly executed and filed by Markus Hartmann, as an authorized person, to form a limited liability company under the Delaware Limited Liability Company Act.

FIRST. The name of the limited liability company is Reckitt Benckiser LLC (hereinafter referred to as the "Company").

SECOND. The address of the registered office of the Company in the State of Delaware is 2711 Centerville Road, Suite 400, Wilmington, Delaware 19808. The name of the registered agent of the Company for service of process at such address is Corporation Service Company.

THIRD. The effective time of the filing of this Certificate of Formation shall be 12:00 midnight at the end of December 31, 2010.

IN WITNESS WHEREOF, the undersigned has executed this Certificate of Formation and affirms the truth of the statements contained herein under penalties of perjury.

Markus Hartmann, Authorized Person

Delaware

The First State

I, JEFFREY W. BULLOCK, SECRETARY OF STATE OF THE STATE OF DELAWARE DO HEREBY CERTIFY THAT THE ATTACHED IS A TRUE AND CORRECT COPY OF THE CERTIFICATE OF CONVERSION OF A DELAWARE CORPORATION UNDER THE NAME OF "RECKITT BENCKISER INC." TO A DELAWARE LIMITED LIABILITY COMPANY, CHANGING ITS NAME FROM "RECKITT BENCKISER INC." TO "RECKITT BENCKISER LLC", FILED IN THIS OFFICE ON THE TWENTY-FIRST DAY OF DECEMBER, A.D. 2010, AT 5:12 O'CLOCK P.M.

AND I DO HEREBY FURTHER CERTIFY THAT THE EFFECTIVE DATE OF THE AFORESAID CERTIFICATE OF CONVERSION IS THE THIRTY-FIRST DAY OF DECEMBER, A.D. 2010, AT 12 O'CLOCK A.M.

SECRETARY'S OFFICE 1793 DELAWARE 1855

Jeffrey W. Bullock, Secretary of State

0839519 8100V

101219142

AUTHENTICATION: 8452156

DATE: 12-23-10

You may verify this certificate online at corp.delaware.gov/authver.shtml

State of Delaware
Secretary of State
Division of Corporations
Delivered 05:17 PM 12/21/2010
FILED 05:12 PM 12/21/2010
SRV 101219142 - 0839519 FILE

CERTIFICATE OF CONVERSION
OF
RECKITT BENCKISER INC.
INTO
RECKITT BENCKISER LLC

(Pursuant to Section 266 of the
Delaware General Corporation Law and Section 18-214 of the Delaware Limited
Liability Company Act)

---

1. The name of the corporation immediately prior to the filing of this Certificate of Conversion is Reckitt Benckiser Inc.

2. The date of filing of its original Certificate of Incorporation with the Secretary of State of the State of Delaware is June 10, 1977.

3. The name of the limited liability company into which the corporation shall be converted, as stated on its Certificate of Formation, is Reckitt Benckiser LLC.

4. The conversion shall be effective at 12:00 midnight at the end of December 31, 2010.

5. The conversion has been approved in accordance with the provisions of Section 266 of the Delaware General Corporation Law.

Dated: December 17, 2010

RECKITT BENCKISER INC.

By Markus Hartmann

Name: Markus Hartmann
Title: Vice President

Glenn A. Harris, Esquire
BALLARD SPAHR LLP
A Pennsylvania Limited Liability Partnership
210 Lake Drive East, Suite 200
Cherry Hill, New Jersey 08002
Phone: 856.761.3400
Fax: 856.761.1020

Attorneys for Vertellus Specialties Inc. and Rutherford Chemicals LLC

NEW JERSEY DEPARTMENT OF ENVIRONMENTAL PROTECTION and THE ADMINISTRATOR OF THE NEW JERSEY SPILL COMPENSATION FUND, Plaintiffs, v. OCCIDENTAL CHEMICAL CORPORATION, TIERRA SOLUTIONS, INC., MAXUS ENERGY CORPORATION, REPSOL YPF, S.A., YPF, S.A., YPF HOLDINGS, INC. and CLH HOLDINGS, INC., Defendants. MAXUS ENERGY CORPORATION and TIERRA SOLUTIONS, INC., Third-Party Plaintiffs, vs. 3M COMPANY, *et al.*, Third-Party Defendants.	SUPERIOR COURT OF NEW JERSEY LAW DIVISION: ESSEX COUNTY DOCKET NO. L-9868-05 CIVIL ACTION **CERTIFICATION OF THOMAS E. MESEVAGE**

Thomas E. Mesevage, being of full age, makes the following certified statements:

1. I am Corporate Counsel, Environmental, for Vertellus Specialties Inc. ("VSI"). I am the corporate counsel in charge of this litigation for both VSI and for Rutherford Chemicals LLC ("Rutherford"), both of which are Third-Party Defendants in this action.

2. I have personal knowledge of the facts set forth herein.

3. Rutherford is an indirect wholly-owned subsidiary of VSI.

4. Thus, Rutherford is a Named Affiliated Entity with respect to VSI.

I certify that the foregoing statements made by me are true. I am aware that if any of the foregoing statements made by me are wilfully false, I am subject to punishment.

By: Thomas E. Mesevage
Thomas E. Mesevage

DATED: March 18, 2013

DF
PC

The Commonwealth of Massachusetts

William Francis Galvin
Secretary of the Commonwealth
One Ashburton Place, Boston, Massachusetts 02108-1512

FORM MUST BE TYPED **Articles of Merger** FORM MUST BE TYPED

Involving Domestic Corporations, Foreign Corporations or Foreign Other Entities

(General Laws Chapter 156D, Section 11.06; 950 CMR 113.37)

Exact name, jurisdiction and date of organization of each party to the merger:

(1) EXACT NAME	(2) JURISDICTION	DATE OF ORGANIZATION
Siemens Water Technologies Holding Corp.	Delaware	4/12/2004
Siemens Water Technologies Corp.	Massachusetts	9/19/1989

(3) The foreign corporation or other entity ☐ is / ☒ is not* authorized to conduct business in the Commonwealth.

(4) Exact name of the surviving entity: Siemens Water Technologies Holding Corp.

(5) Jurisdiction under the laws of which the surviving entity will be organized: Delaware

(6) The merger shall be effective at the time and on the date approved by the Division, unless a later effective date not more than 90 days from the date and time of filing is specified: 12:01 a.m., April 1, 2011

(7-8) For each domestic corporation that is a party to the merger:**

(check appropriate box)

☒ The plan of merger was duly approved by the shareholders, and where required, by each separate voting group as provided by G.L. Chapter 156D and the articles of organization.

OR

☐ The plan of merger did not require the approval of the shareholders.

(9) Participation of each other domestic entity, foreign corporation, or foreign other entity was duly authorized by the law under which the other entity or foreign corporation is organized and by its organizational documents.

* *Check appropriate box*
** *Provide this information for each domestic corporation separately*

P.C.

(10) Attach any amendment to articles of organization of the surviving entity, where the survivor is a domestic business corporation.

(11) Attach the articles of organization of the surviving entity, where the survivor is a NEW domestic business corporation, including all the supplemental information required by 950 CMR 113.16.

(12) State the executive office address of the surviving foreign other entity if such information is not on the public record in the foreign jurisdiction: 181 Thorn Hill Road, Warrendale, PA 15086

(number, street, city or town, state, zip code)

Signed by: ______________________________,
Bjoern H. Fischer (signature of authorized individual)
Executive Vice President, Chief Financial Officer & Treasurer

- ☐ Chairman of the board of directors,
- ☐ President,
- ☒ Other officer,
- ☐ Court-appointed fiduciary,

on this 14th day of March, 2011.

Signed by: ______________________________,
Vincent Grieco (signature of authorized individual)
Vice President & Secretary

- ☐ Chairman of the board of directors,
- ☐ President,
- ☒ Other officer,
- ☐ Court-appointed fiduciary,

on this 14th day of March, 2011.

THE COMMONWEALTH OF MASSACHUSETTS

I hereby certify that, upon examination of this document, duly submitted to me, it appears that the provisions of the General Laws relative to corporations have been complied with, and I hereby approve said articles; and the filing fee having been paid, said articles are deemed to have been filed with me on:

March 28, 2011 01:59 PM

William Francis Galvin

WILLIAM FRANCIS GALVIN

Secretary of the Commonwealth

Delaware

The First State

I, JEFFREY W. BULLOCK, SECRETARY OF STATE OF THE STATE OF DELAWARE, DO HEREBY CERTIFY THE ATTACHED IS A TRUE AND CORRECT COPY OF THE CERTIFICATE OF MERGER, WHICH MERGES:

"SIEMENS WATER TECHNOLOGIES CORP.", A MASSACHUSETTS CORPORATION,

WITH AND INTO "SIEMENS WATER TECHNOLOGIES HOLDING CORP." UNDER THE NAME OF "SIEMENS WATER TECHNOLOGIES HOLDING CORP.", A CORPORATION ORGANIZED AND EXISTING UNDER THE LAWS OF THE STATE OF DELAWARE, AS RECEIVED AND FILED IN THIS OFFICE THE TWENTY-EIGHTH DAY OF MARCH, A.D. 2011, AT 3:37 O'CLOCK P.M.

AND I DO HEREBY FURTHER CERTIFY THAT THE EFFECTIVE DATE OF THE AFORESAID CERTIFICATE OF MERGER IS THE FIRST DAY OF APRIL, A.D. 2011, AT 12:01 O'CLOCK A.M.

A FILED COPY OF THIS CERTIFICATE HAS BEEN FORWARDED TO THE NEW CASTLE COUNTY RECORDER OF DEEDS.

Jeffrey W. Bullock, Secretary of State

3789414 8100M

AUTHENTICATION: 8654511

110347806

DATE: 03-29-11

You may verify this certificate online at corp.delaware.gov/authver.shtml

State of Delaware
Secretary of State
Division of Corporations
Delivered 04:07 PM 03/28/2011
FILED 03:37 PM 03/28/2011
SRV 110347806 - 3789414 FILE

CERTIFICATE OF MERGER

OF

SIEMENS WATER TECHNOLOGIES CORP.

WITH AND INTO

SIEMENS WATER TECHNOLOGIES HOLDING CORP.

Pursuant to Section 252 of the Delaware General Corporation Law (the "DGCL"), Siemens Water Technologies Holding Corp., a Delaware corporation ("SW Holding"), hereby certifies the following information relating to the merger of Siemens Water Technologies Corp., a Massachusetts corporation ("SWT") with and into SW Holding (the "Merger").

1. The names and states of incorporation of each of the constituent corporations that are to merge in the Merger (the "Constituent Corporations"), are:

Name	State of Incorporation
Siemens Water Technologies Corp.	Massachusetts
Siemens Water Technologies Holding Corp.	Delaware

2. An Agreement and Plan of Merger, dated as of March 14, 2011, by and between SWT and SW Holding (the "Merger Agreement"), setting forth the terms and conditions of the Merger, has been approved, adopted, certified, executed and acknowledged by each of the Constituent Corporations in accordance with the provisions of Section 252 of the DGCL.

3. The name of the corporation surviving the Merger will be Siemens Water Technologies Holding Corp.

4. The Certificate of Incorporation of SW Holding shall be the certificate of incorporation of the surviving corporation.

5. The executed Merger Agreement is on file at the offices of the surviving corporation at Siemens Water Technologies Holding Corp., 181 Thorn Hill Road, Warrendale, PA 15086.

6. A copy of the Merger Agreement will be furnished by the surviving corporation, on request and without cost, to any stockholder of either of the Constituent Corporations.

7. The Merger shall not become effective upon the filing of this Certificate, but instead shall become effective at 12:01 a.m. on April 1, 2011.

IN WITNESS WHEREOF, this Certificate of Merger has been executed by the undersigned Siemens Water Technologies Holding Corp. on this 14th day of March, 2011.

SIEMENS WATER TECHNOLOGIES HOLDING CORP.

By:________________________
Name: Bjoern H. Fischer
Title: Executive Vice President, Chief Financial Officer & Treasurer

By:________________________
Name: Vincent Grieco
Title: Secretary

Delaware

The First State

I, JEFFREY W. BULLOCK, SECRETARY OF STATE OF THE STATE OF DELAWARE, DO HEREBY CERTIFY THE ATTACHED IS A TRUE AND CORRECT COPY OF THE CERTIFICATE OF OWNERSHIP, WHICH MERGES:

"SIEMENS WATER TECHNOLOGIES HOLDING CORP.", A DELAWARE CORPORATION,

WITH AND INTO "SIEMENS INDUSTRY, INC." UNDER THE NAME OF "SIEMENS INDUSTRY, INC.", A CORPORATION ORGANIZED AND EXISTING UNDER THE LAWS OF THE STATE OF DELAWARE, AS RECEIVED AND FILED IN THIS OFFICE THE TWENTY-EIGHTH DAY OF MARCH, A.D. 2011, AT 4:07 O'CLOCK P.M.

AND I DO HEREBY FURTHER CERTIFY THAT THE EFFECTIVE DATE OF THE AFORESAID CERTIFICATE OF OWNERSHIP IS THE FIRST DAY OF APRIL, A.D. 2011, AT 12:05 O'CLOCK A.M.

A FILED COPY OF THIS CERTIFICATE HAS BEEN FORWARDED TO THE NEW CASTLE COUNTY RECORDER OF DEEDS.

SECRETARY OF STATE
1776 DELAWARE 1970

Jeffrey W. Bullock, Secretary of State

0786939 8100M

AUTHENTICATION: 8655076

110347818

DATE: 03-29-11

State of Delaware
Secretary of State
Division of Corporations
Delivered 04:07 PM 03/28/2011
FILED 04:07 PM 03/28/2011
SRV 110347818 - 0786939 FILE

CERTIFICATE OF OWNERSHIP

MERGING

SIEMENS WATER TECHNOLOGIES HOLDING CORP.

INTO

SIEMENS INDUSTRY, INC.
(Subsidiary into parent pursuant to Section 253 of the General Corporation Law of Delaware)

* * * * * * *

Siemens Industry, Inc., a corporation incorporated on the 28th day of November, 1972, pursuant to the provisions of the General Corporation Law of the State of Delaware;

DOES HEREBY CERTIFY:

FIRST: That this corporation owns 90% of the capital stock of Siemens Water Technologies Holding Corp., a corporation incorporated on the 12th day of April, 2004 A.D., pursuant to the provisions of the Delaware General Corporation Law and that this corporation, by a resolution of its Board of Directors duly adopted at a meeting held on the 12th day of May, 2010 A.D., determined to merge into itself said Siemens Water Technologies Holding Corp., which resolution is in the following words to wit:

WHEREAS this corporation lawfully owns 90% of the outstanding stock of Siemens Water Technologies Holding Corp., a corporation organized and existing under the laws of Delaware, and

WHEREAS this corporation desires to merge into itself the said Siemens Water Technologies Holding Corp., and to be possessed of all the estate, property, rights, privileges and franchises of said corporation,

NOW, THEREFORE, BE IT RESOLVED, that this corporation merge into itself said Siemens Water Technologies Holding Corp. and assumes all of its obligations, and

FURTHER RESOLVED, that an authorized officer of this corporation be and he or she is hereby directed to make and execute a certificate of ownership setting forth a copy of the resolution to merge said Siemens Water Technologies Holding Corp. and assume its liabilities and obligations, and the date of adoption thereof, and to file the same in the office of the Secretary of State of Delaware, and a certified copy thereof in the office of the Recorder of Deeds of New Castle County; and

FURTHER RESOLVED, that the officers of this corporation be and they hereby are authorized and directed to do all acts and things whatsoever, whether within or without the State of Delaware; which may be in any way necessary or proper to effect said merger.

FURTHER RESOLVED, that the merger shall become effective at 12:05 a.m. on April 1, 2011.

SECOND: That anything herein or elsewhere to the contrary notwithstanding, this merger may be amended or terminated and abandoned by the Board of Directors of Siemens Industry, Inc. at any time prior to the time that this merger filed with the Secretary of State becomes effective.

IN WITNESS WHEREOF, said parent corporation has caused its corporate seal to be affixed and this Certificate to be signed by an authorized officer this 15 day of March, 2011.

By: ____________________

Name: DANIEL W. HISLOP

SECRETARY

Title: ____________________

10-K 1 d264773d10k.htm SUNOCO INC--FORM 10-K

Table of Contents

2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2011

OR

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission file number 1-6841

SUNOCO, INC.

(Exact name of registrant as specified in its charter)

Pennsylvania (State or other jurisdiction of incorporation or organization)	23-1743282 (I.R.S. Employer Identification No.)
1818 Market Street, Suite 1500, Philadelphia, PA (Address of principal executive offices)	19103 (Zip Code)

Registrant's telephone number, including area code (215) 977-3000

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, $1 par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☒ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

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

Large accelerated filer ☒	Accelerated filer ☐
Non-accelerated filer ☐ (Do not check if a smaller reporting company)	Smaller reporting company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ☐ No ☒

At June 30, 2011, the aggregate market value of voting stock held by non-affiliates was $5,046 million.

At January 31, 2012, there were 106,816,757 shares of Common Stock, $1 par value, outstanding.

Selected portions of the Sunoco, Inc. definitive Proxy Statement, which will be filed with the Securities and Exchange Commission within 120 days after December 31, 2011, are incorporated by reference in Part III of this Form 10-K.

Table of Contents

TABLE OF CONTENTS

Table of Contents

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) The following documents are filed as a part of this report:

1. Consolidated Financial Statements:

   The consolidated financial statements are set forth under Item 8 of this report.

2. Financial Statement Schedules:

   These schedules are omitted because the required information is shown elsewhere in this report, is not necessary or is not applicable.

3. Exhibits:

3.(i)	—Amendment to the Articles of Incorporation of Sunoco, Inc., effective December 3, 2009 (incorporated by reference to Exhibit 3.1 of the Company's Current Report on Form 8-K dated December 4, 2009, File No. 1-6841). The Articles of Incorporation of Sunoco, Inc. as amended and restated as of March 1, 2006 are incorporated by reference to Exhibit 3.(i) of the Company's 2005 Form 10-K filed March 3, 2006, File No. 1-6841.
3.(ii)	—Sunoco, Inc. Bylaws, as amended and restated as of December 3, 2009 (incorporated by reference to Exhibit 3.2 of the Company's Current Report on Form 8-K dated December 4, 2009, File No. 1-6841).
4	—Instruments defining the rights of security holders of long-term debt of the Company and its subsidiaries are not being filed since the total amount of securities authorized under each such instrument does not exceed 10 percent of the total assets of the Company and its subsidiaries on a consolidated basis. The Company will provide the SEC a copy of any instruments defining the rights of holders of long-term debt of the Company and its subsidiaries upon request.
10.1*	—Sunoco, Inc. Long-Term Performance Enhancement Plan, as amended and restated effective November 1, 2007 (incorporated by reference to Exhibit 10.1 of the Company's 2007 Form 10-K filed February 27, 2008, File No. 1-6841).
10.2*	—Sunoco, Inc. Long-Term Performance Enhancement Plan II, as amended and restated effective December 3, 2008 (incorporated by reference to Exhibit 10.2 of the Company's 2008 Form 10-K filed February 25, 2009, File No. 1-6841).
10.2.1*	—Form of Common Stock Unit Agreement under the Sunoco, Inc. Long-Term Performance Enhancement Plan II (incorporated by reference to Exhibit 10.3 of the Company's 2008 Form 10-K filed February 25, 2009, File No. 1-6841).
10.2.2*	—Form of Common Stock Unit Agreement under the Sunoco, Inc. Long-Term Performance Enhancement Plan II (incorporated by reference to Exhibit 10.4 of the Company's 2008 Form 10-K filed February 25, 2009, File No. 1-6841).
10.2.3*	—Form of Common Stock Unit Agreement under the Sunoco, Inc. Long-Term Performance Enhancement Plan II (incorporated by reference to Exhibit 10.5 of the Company's 2008 Form 10-K filed February 25, 2009, File No. 1-6841).
10.2.4*	—Form of Common Stock Unit Agreement under the Sunoco, Inc. Long-Term Performance Enhancement Plan II (incorporated by reference to Exhibit 10.6 of the Company's 2008 Form 10-K filed February 25, 2009, File No. 1-6841).
10.2.5*	—Form of Stock Option Agreement under the Sunoco, Inc. Long-Term Performance Enhancement Plan II (incorporated by reference to Exhibit 10.7 of the Company's 2008 Form 10-K filed February 25, 2009, File No. 1-6841).

Table of Contents

10.3*	—Sunoco, Inc. Directors' Deferred Compensation Plan I, as amended and restated effective September 4, 2008 (incorporated by reference to Exhibit 10.1 of the Company's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2008 filed November 6, 2008, File No. 1-6841).
10.4*	—Sunoco, Inc. Directors' Deferred Compensation Plan II, as amended and restated effective June 30, 2010 (incorporated by reference to Exhibit 10.4 of the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2010 filed August 5, 2010, File No. 1-6841).
10.5*	—Sunoco, Inc. Deferred Compensation Plan, as amended and restated effective November 1, 2007 (incorporated by reference to Exhibit 10.9 of the Company's 2007 Form 10-K filed February 27, 2008, File No. 1-6841).
10.6*	—Sunoco, Inc. Pension Restoration Plan, as amended and restated effective March 17, 2010 (incorporated by reference to Exhibit 10.8 of the Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2010 filed May 6, 2010, File No. 1-6841).
10.7*	—Sunoco, Inc. Savings Restoration Plan, as amended and restated as of March 17, 2010, including amendments effective July 1, 2010 (incorporated by reference to Exhibit 10.6 of the Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2010 filed May 6, 2010, File No. 1-6841).
10.8*	—Sunoco, Inc. Executive Retirement Plan, as amended and restated as of March 17, 2010, including amendments effective June 30, 2010 (incorporated by reference to Exhibit 10.7 of the Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2010 filed May 6, 2010, File No. 1-6841).
10.9*	—Sunoco, Inc. Special Executive Severance Plan, as amended and restated effective December 1, 2010 (incorporated by reference to Exhibit 10.9 of the Company's 2010 Form 10-K filed February 28, 2011, File No. 1-6841).
10.10*	—Sunoco, Inc. Executive Involuntary Severance Plan, as amended and restated effective December 1, 2010 (incorporated by reference to Exhibit 10.10 of the Company's 2010 Form 10-K filed February 28, 2011, File No. 1-6841).
10.11*	—Sunoco, Inc. Retainer Stock Plan for Outside Directors, as amended and restated effective May 7, 2009 (incorporated by reference to Exhibit A to Sunoco, Inc. Definitive Proxy Statement on Schedule 14A filed on March 17, 2009, File No. 1-6841).
10.12*	—Sunoco, Inc. Executive Involuntary Deferred Compensation Plan, effective March 3, 2010 (incorporated by reference to Exhibit 10.5 of the Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2010 filed May 6, 2010, File No. 1-6841).
10.12.1*	—Amendment No. 2011-1 to Sunoco, Inc. Executive Involuntary Deferred Compensation Plan (incorporated by reference to Exhibit 10.12.1 of the Company's 2010 Form 10-K filed February 28, 2011, File No. 1-6841).
10.13*	—Sunoco, Inc. Senior Executive Incentive Plan, effective as of January 1, 2010 (incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K dated May 11, 2010, File No. 1-6841).
10.13.1*	—Amendment No. 2011-1 to Sunoco, Inc. Senior Executive Incentive Plan (incorporated by reference to Exhibit 10.13.1 of the Company's 2010 Form 10-K filed February 28, 2011, File No. 1-6841).
10.14*	—Sunoco, Inc. Long-Term Performance Enhancement Plan III, effective March 2, 2011 (incorporated by reference to Exhibit 10.4 of the Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2011 filed May 5, 2011, File No. 1-6841).

Table of Contents

10.14.1*	—Form of Restricted Share Unit Agreement under the Sunoco, Inc. Long-Term Performance Enhancement Plan III (incorporated by reference to Exhibit 10.14.1 of the Company's 2010 Form 10-K filed February 28, 2011, File No. 1-6841).
10.14.2*	—Form of Performance Share Unit Agreement under the Sunoco, Inc. Long-Term Performance Enhancement Plan III (incorporated by reference to Exhibit 10.14.2 of the Company's 2010 Form 10-K filed February 28, 2011, File No. 1-6841).
10.14.3*	—Form of Stock Option Agreement under the Sunoco, Inc. Long-Term Performance Enhancement Plan III (incorporated by reference to Exhibit 10.14.3 of the Company's 2010 Form 10-K filed February 28, 2011, File No. 1-6841).
10.15*	—Form of Second Amended and Restated Indemnification Agreement, individually entered into between Sunoco, Inc. and various directors, officers and other key employees of the Company (incorporated by reference to Exhibit 10.10 of the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2008 filed August 7, 2008, File No. 1-6841).
10.16*	—Form of Amendment to Amended and Restated Indemnification Agreement (incorporated by reference to Exhibit 10.19 of the Company's 2007 Form 10-K filed February 27, 2008, File No. 1-6841).
10.16.1*	—The Amended Schedule to the Forms of Indemnification Agreement.
10.17*	—Directors' Deferred Compensation and Benefits Trust Agreement, by and among Sunoco, Inc., Mellon Trust of New England, N.A. (predecessor to Bank of New York Mellon) and Towers, Perrin, Forster & Crosby, Inc., amended and restated as of November 1, 2007 (incorporated by reference to Exhibit 10.12 of the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2008 filed August 7, 2008, File No. 1-6841).
10.17.1*	—Amended Schedule 2.1 of Directors' Deferred Compensation and Benefits Trust Agreement, by and among Sunoco, Inc., Mellon Trust of New England, N.A. (predecessor to Bank of New York Mellon) and Towers, Perrin, Forster & Crosby, Inc.
10.18*	—Deferred Compensation and Benefits Trust Agreement, by and among Sunoco, Inc., Mellon Trust of New England, N.A. (predecessor to Bank of New York Mellon) and Towers, Perrin, Forster & Crosby, Inc., amended and restated as of November 1, 2007 (incorporated by reference to Exhibit 10.13 of the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2008 filed August 7, 2008, File No. 1-6841).
10.18.1*	—Amended Schedule 2.1 of Deferred Compensation and Benefits Trust Agreement, by and among Sunoco, Inc., Mellon Trust of New England, N.A. (predecessor to Bank of New York Mellon) and Towers, Perrin, Forster & Crosby, Inc.
10.19*	—Offer Letter with Stacy L. Fox, dated January 19, 2010 (incorporated by reference to Exhibit 10.9 of the Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2010 filed May 6, 2010, File No. 1-6841).
10.20*	—Offer Letter with Frederick A. Henderson, dated September 2, 2010 (incorporated by reference to Exhibit 10.3 of the Company's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2010 filed November 4, 2010, File No. 1-6841).
10.21*	—Letter Agreement with Michael J. Thomson, dated September 2, 2010 (incorporated by reference to Exhibit 10.4 of the Company's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2010 filed November 4, 2010, File No. 1-6841).
10.22	—Separation and Distribution Agreement, dated as of July 18, 2011, by and between SunCoke Energy, Inc. and Sunoco, Inc. (incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K dated July 22, 2011, File No. 1-6841).

Table of Contents

10.23	—Tax Sharing Agreement, dated as of July 18, 2011, by and between SunCoke Energy, Inc. and Sunoco, Inc. (incorporated by reference to Exhibit 10.3 of SunCoke Energy, Inc.'s Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2011 filed August 3, 2011, File No. 333-173022).
10.24	—$800 Million Credit Agreement, dated as of November 22, 2011, by and among Sunoco, Inc., the Loan Guarantors party thereto, the Lenders party thereto, and J.P. Morgan Chase Bank, N.A., as Administrative Agent (incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K dated November 29, 2011, File No. 1-6841).
10.25	—Omnibus Agreement, dated as of February 8, 2002, among Sunoco, Inc., Sunoco, Inc. (R&M), Sun Pipe Line Company of Delaware, Atlantic Petroleum Corporation, Sunoco Texas Pipe Line Company, Sun Pipe Line Services (Out) LLC, Sunoco Logistics Partners L.P., Sunoco Logistics Partners Operations L.P., and Sunoco Partners LLC (incorporated by reference to Exhibit 10.5 of the 2001 Form 10-K filed by Sunoco Logistics Partners L.P. on April 1, 2002, File No. 1-31219).
10.25.1	—Amendment No. 2011-1 to Omnibus Agreement, dated as of February 22, 2011, and effective January 1, 2011, by and among Sunoco, Inc., Sunoco, Inc. (R&M), Sun Pipe Line Company of Delaware LLC, Atlantic Petroleum Corporation, Sunoco Pipeline L.P., Sunoco Logistics Partners L.P., Sunoco Logistics Partners Operations L.P., and Sunoco Partners LLC (incorporated by reference to Exhibit 10.23.1 of the Company's 2010 Form 10-K filed February 28, 2011, File No. 1-6841).
10.26	—Product Terminal Services Agreement, dated as of May 1, 2007, among Sunoco, Inc. (R&M) and Sunoco Partners Marketing & Terminals L.P. (incorporated by reference to Exhibit 10.1 of Sunoco Logistics Partners L.P.'s Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2007 filed July 31, 2007, File No. 1-31219).
10.27*	—Offer Letter with Lynn Laverty Elsenhans, dated July 15, 2008 (incorporated by reference to Exhibit 10.2 of the Company's Current Report on Form 8-K dated July 16, 2008, File No. 1-6841).
10.28*	—Offer Letter with Dennis Zeleny, dated January 12, 2009 (incorporated by reference to Exhibit 10.27 of the Company's 2008 Form 10-K filed February 25, 2009, File No. 1-6841).
10.29*	—Offer Letter with Brian P. MacDonald, dated June 30, 2009 (incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K dated July 7, 2009, File No. 1-6841).
10.30*	—Amendment No. 1 to Letter Agreement between Frederick A. Henderson and Sunoco, Inc. dated May 25, 2011 (incorporated by reference to Exhibit 10.11 to Amendment No. 2 to SunCoke Energy, Inc.'s Registration Statement on Form S-1 filed on June 3, 2011, File No. 333-173022)
14	—Sunoco, Inc. Code of Business Conduct and Ethics (incorporated by reference to Exhibit 14 of the Company's 2005 Form 10-K filed March 3, 2006, File No. 1-6841).
21	—Subsidiaries of Sunoco, Inc.
23	—Consent of Independent Registered Public Accounting Firm.
24.1	—Power of Attorney executed by certain officers and directors of Sunoco, Inc.
24.2	—Certified copy of the resolution authorizing certain officers to sign on behalf of Sunoco, Inc.
31.1	—Certification Pursuant to Exchange Act Rule 13a-14(a) or Rule 15d-14(a), as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	—Certification Pursuant to Exchange Act Rule 13a-14(a) or Rule 15d-14(a), as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	—Certification Pursuant to Exchange Act Rule 13a-14(b) or Rule 15d-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Table of Contents

32.2	—Certification Pursuant to Exchange Act Rule 13a-14(b) or Rule 15d-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
95	—Mine Safety Disclosures.
101	—The following financial statements from Sunoco, Inc.'s Annual Report on Form 10-K for the year ended December 31, 2011, filed with the Securities and Exchange Commission on February 28, 2012, formatted in XBRL (eXtensible Business Reporting Language): (i) the Consolidated Statements of Operations; (ii) the Consolidated Balance Sheets; (iii) the Consolidated Statements of Cash Flows; (iv) the Consolidated Statements of Comprehensive Income (Loss) and Equity; and (v) the Notes to Consolidated Financial Statements.

* These exhibits constitute the Executive Compensation Plans and Arrangements of the Company.

Note: Copies of each Exhibit to this Form 10-K are available upon request.

Table of Contents

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

SUNOCO, INC.

BY /s/ BRIAN P. MACDONALD
Brian P. MacDonald
Senior Vice President and
Chief Financial Officer

Date February 28, 2012

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by or on behalf of the following persons on behalf of the registrant and in the capacities indicated on February 28, 2012:

IRENE C. BRITT*
Irene C. Britt, Director

CHRIS C. CASCIATO*
Chris C. Casciato, Director

WILLIAM H. EASTER, III*
William H. Easter, III, Director

GARY W. EDWARDS*
Gary W. Edwards, Director

LYNN L. ELSENHANS*
Lynn L. Elsenhans
Chairman, Chief Executive Officer,
President and Director
(Principal Executive Officer)

URSULA O. FAIRBAIRN*
Ursula O. Fairbairn, Director

JOHN P. JONES, III*
John P. Jones, III, Director

JAMES G. KAISER*
James G. Kaiser, Director

JOSEPH P. KROTT*
Joseph P. Krott, Comptroller
(Principal Accounting Officer)

BRIAN P. MACDONALD*
Brian P. MacDonald
Senior Vice President and Chief Financial Officer
(Principal Financial Officer)

JOHN K. WULFF*
John K. Wulff, Director

*By /s/ BRIAN P. MACDONALD
Brian P. MacDonald
Individually and as Attorney-in-Fact

EX-21 5 d264773dex21.htm SUBSIDIARIES OF SUNOCO, INC.

Exhibit 21
DECEMBER 31, 2011

SUNOCO, INC.
SUBSIDIARIES OF THE REGISTRANT

COMPANY NAME:	INC./ORG./REG.
Mascot, Inc. (MA)	MA
Sun Alternate Energy Corporation	DE
Sun Atlantic Refining and Marketing Company	DE
Sun Atlantic Refining and Marketing B.V., Inc.	DE
Sun Atlantic Refining and Marketing B.V.	Netherlands
Atlantic Petroleum Corporation	DE
Atlantic Petroleum Delaware Corporation	DE
Atlantic Petroleum (Out) LLC	DE
Atlantic Pipeline (Out) L.P.	TX
Atlantic Refining & Marketing Corp.	DE
Sun Canada, Inc.	DE
Helios Assurance Company Limited	Bermuda
Sun International Limited	Bermuda
Sun Mexico One, Inc.	DE
Sunoco de Mexico, S.A. de C.V.	Mexico
Sun Mexico Two, Inc.	DE

DECEMBER 31, 2011

SUNOCO, INC.
SUBSIDIARIES OF THE REGISTRANT

COMPANY NAME:	INC./ORG./REG.
Sun Company, Inc. *(name saver company)*	DE
Sun Company, Inc. *(name saver company)*	PA
Sun Oil Company *(name saver company)*	DE

DECEMBER 31, 2011

SUNOCO, INC.
SUBSIDIARIES OF THE REGISTRANT

COMPANY NAME:	INC./ORG./REG.
Sun Oil Export Company	DE
Sun Oil International, Inc.	DE
Sun-Del Pipeline LLC	DE
Mid-Continent Pipe Line (Out) LLC	TX
Sun Pipe Line Company	TX
Sunoco Partners LLC	PA
Sun Pipe Line Delaware (Out) LLC	DE
Sun Refining and Marketing Company *(name saver company)*	DE
Sun Services Corporation	PA
Sun Transport, LLC	PA
Jalisco Corporation	CA
Lesley Corporation	DE
Libre Insurance Company, Ltd.	Bermuda
Sun-Del Services, Inc.	DE
SunCoke Energy, Inc.	DE
Sun Coal & Coke Company	DE
Elk River Minerals Corporation	DE
Gateway Energy & Coke Company, LLC	DE
Haverhill North Coke Company	DE
Indiana Harbor Coke Company	DE
Indiana Harbor Coke Corporation	IN
Indiana Harbor Coke Company L.P.	DE
Jewell Coke Acquisition Company	VA
Jewell Coke Company, L.P.	DE
SunCoke Energy South Shore LLC	DE
Jewell Resources Corporation	VA
Dominion Coal Corporation	VA
Harold Keene Coal Co., Inc.	VA
Energy Resources, LLC	VA
Jewell Coal and Coke Company, Inc.	VA
Jewell Smokeless Coal Corporation	VA
Oakwood Red Ash Coal Corporation	VA
Vansant Coal Corporation	VA
Middletown Coke Company, LLC	DE
Sun Coke International, Inc.	DE
Port Talbot Coke Company Limited	England
Sun Coke East Servicos de Coqueificacao Ltda.	Brazil
Sun Coke Europe Holding B.V.	Netherlands
SunCoke International Development Spoika z ograniczona odpowiedzialnoscia	Poland
SunCoke Technology and Development LLC	DE
The Claymont Investment Company LLC	

DECEMBER 31, 2011

SUNOCO, INC.
SUBSIDIARIES OF THE REGISTRANT

COMPANY NAME:	INC./ORG./REG.
Sunoco, Inc. (R&M)	PA
Puerto Rico Sun Oil Company LLC	DE
Sun Lubricants and Specialty Products Inc.	Quebec
Sun Petrochemicals, Inc.	DE
Sunmarks, LLC	DE
BAR-L, Inc.	PA
Sunoco Power Generation LLC	DE
Sunoco Power Marketing L.L.C.	PA
Sunoco Overseas, Inc.	DE
Lugrasa, S.A.	Panama
Sunoco Partners LLC	PA
Sunoco Logistics Partners L.P.	DE
Sunoco Logistics Partners GP LLC	DE
Sunoco Logistics Partners Operations L.P.	DE
Sunoco Logistics Partners Operations GP LLC	DE
Sunoco Partners Marketing & Terminals L.P.	TX
Austin Property Acquisition LLC	DE
Butane Acquisition I LLC	DE
Sunoco Partners Butane Blending LLC	DE
Crude Acquisition LLC	DE
Texon Crude Oil, LLC	DE
Sunoco Partners Crude Operating LLC	DE
Sunoco Partners Rockies LLC	DE
Sunoco Pipeline L.P.	TX
Excel Pipeline LLC	DE
Inland Corporation	OH
West Texas Gulf Pipe Line Company	DE
Sunoco Pipeline Acquisition LLC	DE
Sun Pipe Line Company of Delaware LLC	DE
Mid-Valley Pipeline Company	OH
Sunoco Partners Lease Acquisition & Marketing LLC	DE
Sunoco Receivables Corporation, Inc.	DE
The New Claymont Investment Company	DE
The Sunoco Foundation	PA

BUCHANAN INGERSOLL & ROONEY, PC
550 Broad Street, Suite 810
Newark, New Jersey 07102
(973) 273-9800
Attorney for Third-Party Defendant
TRMI-H LLC

NEW JERSEY DEPARTMENT OF ENVIRONMENTAL PROTECTION, THE COMMISSIONER OF THE NEW JERSEY DEPARTMENT OF ENVIRONMENTAL PROTECTION and THE ADMINISTRATOR OF THE NEW JERSEY SPILL COMPENSATION FUND, Plaintiffs, v. OCCIDENTAL CHEMICAL CORPORATION, TIERRA SOLUTIONS, INC., MAXUS ENERGY CORPORATION, MAXUS INTERNATIONAL ENERGY COMPANY, REPSOL YPF, S.A., YPF, S.A., YPF HOLDINGS, INC., YPF INTERNATIONAL S.A. (f/k/a YPF INTERNATIONAL LTD) and CLH HOLDINGS,INC., Defendants. MAXUS ENERGY CORPORATION and TIERRA SOLUTIONS, INC., Third-Party Plaintiffs, vs. 3M COMPANY, *et al.*, Third-Party Defendants.	SUPERIOR COURT OF NEW JERSEY LAW DIVISION: ESSEX COUNTY DOCKET NO. L-9868-05 (PASR) CIVIL ACTION **CERTIFICATION REGARDING IDENTIFICATION OF CERTAIN UNNAMED AFFILIATED ENTITIES OF TRMI-H LLC**

Frank G. Soler, of full age, hereby certifies as follows:

I am Vice President and Secretary of Texaco Inc. I submit this Certification pursuant to paragraph 2 of Schedule 1 of the proposed Consent Judgment in the matter of New Jersey Department of Environmental Protection, et al. v. Occidental Chemical Corporation, et al., (Docket No. L9869-05) pending in the Superior Court of New Jersey, Law Division – Essex County, to include certain Unnamed Affiliated Entities of TRMI-H LLC in the proposed Consent Judgment as Settling Third Party Defendants.

2. TRMI-H LLC ("TRMI-H") is a named Third Party Defendant in the above-referenced matter. TRMI-H intends to participate in the settlement as reflected in the proposed Consent Judgment as a Settling Third Party Defendant.

3. In addition, pursuant to paragraphs 18.31 and 18.32 of the proposed Consent Judgment and paragraph 2 of the associated Schedule 1, the following Unnamed Affiliated Entities also will participate in the proposed Consent Judgment by executing the Consent Judgment signature page as Settling Third Party Defendants - - Texaco Inc., Texaco Downstream Properties Inc., Kewanee Industries, Inc., and Chevron U.S.A. Inc.

4. TRMI-H, Kewanee Industries, Inc. and Texaco Downstream Properties Inc. are all 100% owned, either directly or indirectly, by Chevron U.S.A. Inc. Chevron U.S.A. Inc. is 100% owned indirectly by Texaco Inc.

I certify that the foregoing statements made by me are true. I am aware that if any of the foregoing statements made by me are willfully false, I am subject to punishment.

Frank G. Soler

Dated: March 14, 2013

BUCHANAN INGERSOLL & ROONEY, PC
550 Broad Street, Suite 810
Newark, New Jersey 07102
(973) 273-9800
Attorney for Third-Party Defendant
TRMI-H LLC

NEW JERSEY DEPARTMENT OF ENVIRONMENTAL PROTECTION, THE COMMISSIONER OF THE NEW JERSEY DEPARTMENT OF ENVIRONMENTAL PROTECTION and THE ADMINISTRATOR OF THE NEW JERSEY SPILL COMPENSATION FUND, Plaintiffs, v. OCCIDENTAL CHEMICAL CORPORATION, TIERRA SOLUTIONS, INC., MAXUS ENERGY CORPORATION, MAXUS INTERNATIONAL ENERGY COMPANY, REPSOL YPF, S.A., YPF, S.A., YPF HOLDINGS, INC., YPF INTERNATIONAL S.A. (f/k/a YPF INTERNATIONAL LTD) and CLH HOLDINGS,INC., Defendants. MAXUS ENERGY CORPORATION and TIERRA SOLUTIONS, INC., Third-Party Plaintiffs, vs. 3M COMPANY, *et al.*, Third-Party Defendants.	SUPERIOR COURT OF NEW JERSEY LAW DIVISION: ESSEX COUNTY DOCKET NO. L-9868-05 (PASR) CIVIL ACTION **CERTIFICATION IDENTIFYING CERTAIN UNNAMED AFFILIATED ENTITIES OF TRMI-H LLC TO BE INCLUDED IN THE CONSENT JUDGMENT**

Robert R. John, of full age, hereby certifies as follows:

1. I am Vice President of Chevron Environmental Management Company.

Chevron Environmental Management Company is an affiliate of Third Party Defendant TRMI-H LLC as well as Unnamed Affiliated Entities Texaco Inc., Texaco Downstream Properties Inc., Kewanee Industries, Inc., and Chevron U.S.A. Inc. By intercompany agreement Chevron Environmental Management Company provides environmental liability management and consulting services to Defendant TRMI-H LLC as well as to Unnamed Affiliated Entities Texaco Inc., Texaco Downstream Properties Inc., Kewanee Industries, Inc., and Chevron U.S.A. Inc.

I submit this Certification pursuant to paragraph 2 of Schedule 1 of the proposed Consent Judgment in the matter of New Jersey Department of Environmental Protection, et al. v. Occidental Chemical Corporation, et al., (Docket No. L9869-05) pending in the Superior Court of New Jersey, Law Division – Essex County, to include certain Unnamed Affiliated Entities of TRMI-H LLC in the proposed Consent Judgment as Settling Third Party Defendants.

2. TRMI-H LLC ("TRMI-H") is a named Third Party Defendant in the above-referenced matter. TRMI-H intends to participate in the settlement as reflected in the proposed Consent Judgment as a Settling Third Party Defendant.

3. In addition, pursuant to paragraphs 18.31 and 18.32 of the proposed Consent Judgment and paragraph 2 of the associated Schedule 1, the following Unnamed Affiliated Entities also will participate in the proposed Consent Judgment by executing the Consent Judgment signature page as Settling Third Party Defendants - - Texaco Inc., Texaco Downstream Properties Inc., Kewanee Industries, Inc., and Chevron U.S.A. Inc.

4. A separate Certification executed by Frank G. Soler explains the corporate affiliation of the entities identified in the preceding paragraph.

5. The information contained in this Certification is being provided pursuant to Paragraph 2A of Schedule 1 to the Consent Judgment to identify each affiliate's connection to sites identified in the Third Party Complaint. Such identification is without admission of any connection to or liability for discharges, if any, from those sites or the alleged migration thereof to the Newark Bay Complex.

Texaco Inc.

6. At various times past, Texaco Inc., held title, either directly or as successor by merger, to the following sites:

(i) A former petroleum storage facility located at 80 Doremus Avenue, Newark, New Jersey (by merger with Paragon Oil);

(ii) A former petroleum storage facility located at 354 Doremus Avenue, Newark, New Jersey; and

(iii) A former petroleum storage and blending facility located at 37 Avenue A, Bayonne, New Jersey and an adjacent former wire and power cable manufacturing facility located at 236 West First Street, Bayonne, New Jersey (the Bergen Point Properties).

7. The above identified sites (with the exception of the Bayonne petroleum storage and blending facility) were identified in the Third Party Complaint with respect to other Third Party Defendants. Third Party Plaintiffs allege that certain other Third Party Defendants were liable for alleged discharges at those sites and the migration thereof to the Newark Bay Complex. Such allegations were not filed against Texaco Inc. With respect to the Bergen Point

Properties, the United States Environmental Protection Agency has issued a General Notice Letter with respect to both parcels.

8. Texaco Inc. is participating, without admission of liability, with other parties (under the supervision of the New Jersey Department of Environmental Protection ("NJDEP")) in the investigation/remediation of the Borne Chemical site located at 600-616 and 532-650 South Front Street, Elizabeth, New Jersey. Several of those parties (but not Texaco Inc.) have been named as Third Party Defendants in connection with their alleged use of the Borne site for the disposal of waste oils and the alleged migration of such waste to the Newark Bay Complex. Such allegations were not filed against Texaco Inc.

Kewanee Industries, Inc.

9. Kewanee Industries, Inc. ("Kewanee") together with a number of other parties, without admission of liability, entered into a Consent Decree with the United States Environmental Protection Agency with respect to the implementation of a remedy at the Bayonne Barrel and Drum Site located at or about 150-154 Raymond Boulevard, Newark, New Jersey. Several of those parties (but not Kewanee) have been named as Third Party Defendants in connection with their alleged use of the site for the recycling of used containers and the alleged discharge of hazardous substances from the Bayonne Barrel and Drum Site to the Newark Bay Complex. Such allegations were not filed against Kewanee.

Texaco Downstream Properties Inc.

10. Texaco Downstream Properties Inc. is the current owner of the Bergen Point Properties identified in Paragraph 6(iii) above.

Chevron U.S.A. Inc. (for itself and as successor by merger to Gulf Oil Corporation ("Gulf")

11. In addition to Texaco Inc., Chevron U.S.A. Inc. is one of the parties funding the investigation/remediation of the Borne Chemical Site in Elizabeth, New Jersey under the supervision of the NJDEP. As described above, several parties (not including Texaco Inc. and Chevron U.S.A. Inc.) have been named as Third Party Defendants in connection with their alleged disposal of waste oil at the site. Such allegations were not filed against Chevron U.S.A. Inc.

12. In addition to the Borne Chemical Site, which is identified in the Third Party Complaint, Chevron U.S.A. Inc. previously owned and operated either directly or as successor by merger, several facilities in proximity to the Newark Bay Complex. Those facilities included:

(i) An asphalt terminal located at 1200 State Street, Perth Amboy, New Jersey, formerly owned by Chevron U.S.A. Inc;

(ii) A former Gulf facility located at 87- 125 Doremus Avenue, Newark, New Jersey;

(iii) A petroleum storage facility located at 26 Marshes Dock Road, Linden, New Jersey, formerly owned by Gulf; and

(iv) A lubes plant located at 330 South Front Street, Elizabeth, New Jersey, formerly owned by Chevron U.S.A. Inc.

13. The four locations listed in the preceding paragraphs are being identified without admission of a discharge to the upland site or impact to the Newark Bay Complex.

I certify that the foregoing statements made by me are true. I am aware that if any of the foregoing statements made by me are willfully false, I am subject to punishment.

Robert R. John

Robert R. John

Dated: March 14, 2013

JOHN J. HOFFMAN
ACTING ATTORNEY GENERAL OF NEW JERSEY
Richard J. Hughes Justice Complex
25 Market Street, PO Box 093
Trenton, New Jersey 08625-0093
Attorney for Plaintiffs

By: John F. Dickinson, Jr.
Deputy Attorney General
(609) 984-4863

JACKSON GILMOUR & DOBBS, PC
3900 Essex Lane, Suite 700
Houston, Texas 77027

By: William J. Jackson, Special Counsel
(713) 355-5000

GORDON & GORDON
505 Morris Avenue
Springfield, New Jersey 07081

By: Michael Gordon, Special Counsel
(973) 467-2400

NEW JERSEY DEPARTMENT OF ENVIRONMENTAL PROTECTION, THE COMMISSIONER OF THE NEW JERSEY DEPARTMENT OF ENVIRONMENTAL PROTECTION and THE ADMINISTRATOR OF THE NEW JERSEY SPILL COMPENSATION FUND,

Plaintiffs,

v.

OCCIDENTAL CHEMICAL CORPORATION, TIERRA SOLUTIONS, INC., MAXUS ENERGY CORPORATION, MAXUS INTERNATIONAL ENERGY COMPANY, REPSOL YPF, S.A., YPF, S.A., YPF HOLDINGS, INC., YPF INTERNATIONAL S.A. (f/k/a YPF INTERNATIONAL LTD.) and CLH HOLDINGS,

Defendants

MAXUS ENERGY CORPORATION and TIERRA SOLUTIONS, INC.,

Third-Party Plaintiffs,

v.

3M COMPANY, *et al.*,

Third-Party Defendants.

SUPERIOR COURT OF NEW JERSEY
LAW DIVISION - ESSEX COUNTY
DOCKET NO. ESX-L9868-05 (PASR)

Civil Action

AFFIDAVIT OF MATTHEW LEPORE IN SUPPORT OF CONSENT JUDGMENT

I, Matthew Lepore, affirm the following under the penalty of perjury:

1. I am employed by Pfizer Inc. as Vice President, Assistant General Counsel and Corporate Secretary.

2. I have knowledge of the facts contained in this affidavit based on a review of Pfizer Inc.'s corporate records.

Shulton, Inc./American Cyanamid Company/Wyeth

3. Pursuant to a Plan of Merger and Agreement and Plan of Reorganization, on February 8, 1971, Shulton, Inc. was acquired by and became a wholly-owned subsidiary of American Cyanamid Company in 1971.

4. On June 10, 1990, American Cyanamid Company entered into an agreement for the sale of Shulton, Inc. stock and certain assets related to the Shulton Inc. business.

5. On July 25, 1990, prior to the closing of the Shulton, Inc. sale, Shulton, Inc. transferred ownership of the facility located in Clifton, New Jersey, which has been identified as the "American Cyanamid Site" as described in Third-Party Plaintiffs' Complaint "D", to American Cyanamid Company.

6. On November 21, 1994, American Cyanamid Company was acquired by American Home Products Corporation.

7. On March 11, 2002, American Home Products Corporation changed its name to Wyeth.

8. On December 30, 2002, American Cyanamid Company changed its name to Wyeth Holdings Corporation.

9. On October 15, 2009, Pfizer Inc., through intermediate subsidiaries, acquired Wyeth.

10. On November 9, 2009, Wyeth converted to a limited liability company and changed its name to Wyeth LLC.

11. Wyeth LLC is currently a wholly-owned subsidiary of Pfizer Inc.

12. Wyeth Holdings Corporation is currently a wholly-owned subsidiary of Pfizer Inc.

<u>Pharmacia Corporation</u>

13. On April 16, 2003, Pfizer Inc. acquired Pharmacia Corporation.

14. On November 30, 2012, Pharmacia Corporation converted to a limited liability company and changed its name to Pharmacia LLC.

15. Pharmacia LLC is currently a wholly-owned subsidiary of Pfizer Inc.

I certify the forgoing statements made by me are true to the best of my knowledge. I am aware that if any of the foregoing statements made by ne are willfully false, I am subject to punishment.

Matthew Lepore
Vice President, Assistant General Counsel &
Corporate Secretary
Pfizer Inc.

Dated: March 11, 2013

STATE OF New York:

SS: Date:March 11, 2013

COUNTY OF NEW YORK :

Personally appeared Matthew Lepore as Vice President, Assistant General Counsel & Corporate Secretary of Pfizer Inc., as Signer of the foregoing Instrument, being thereunto duly authorized, and acknowledged the same to be his/her free act and deed, and the free act and deed of said corporation, before me.

Notary Public
My Commission Expires: 11/19/2014

ANNA L. S. TAN
NOTARY PUBLIC, State of New York
No. 01TA4974662
Qualified in Kings County
Commission Expires November 19, 2014