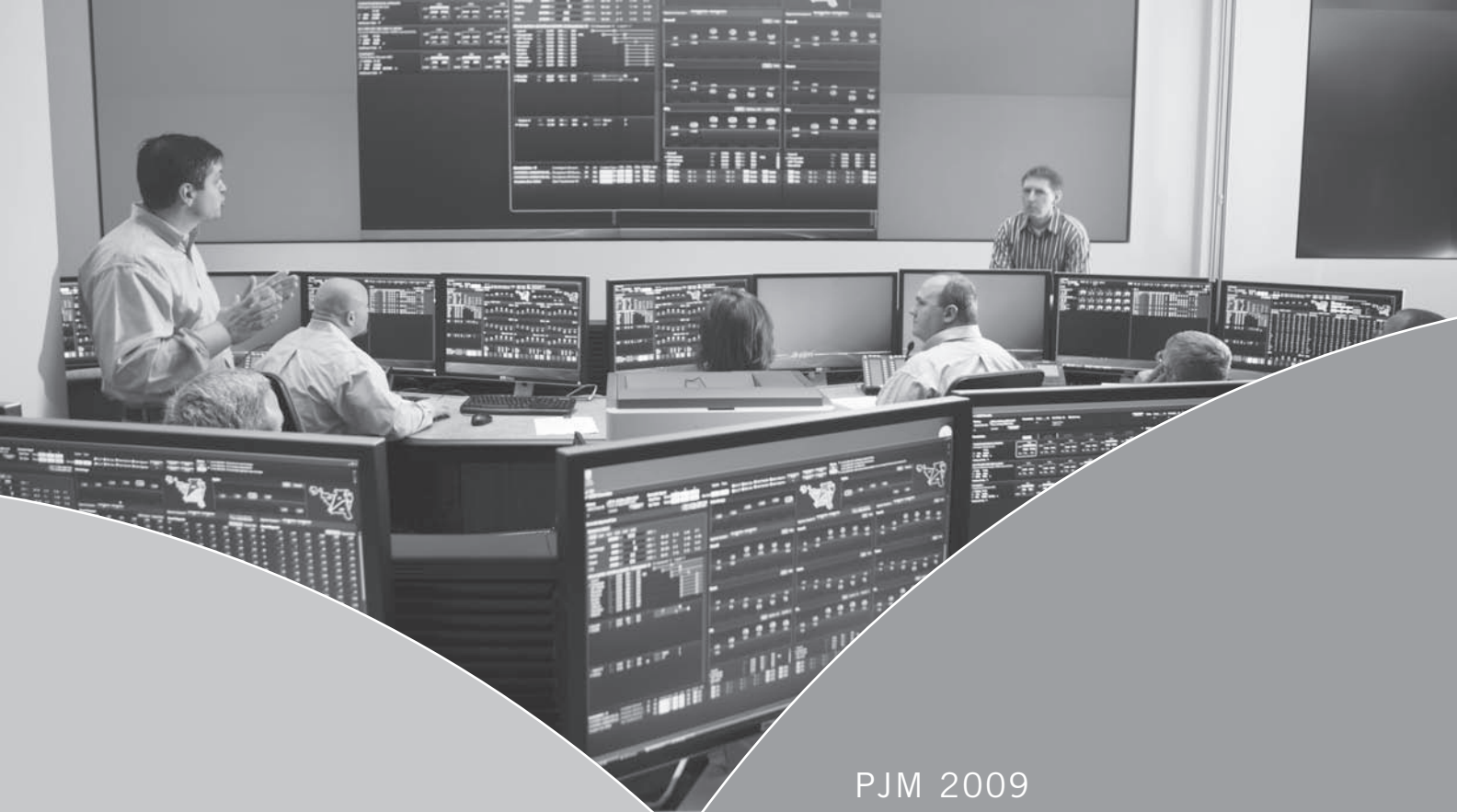


PJM 2009 Financial Report



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PJM 2009

# Financial Report



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## Management's Discussion and Analysis

### Forward-Looking Statements

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

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

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

### Nature of Operations

The Company currently coordinates a pooled generating capacity of more than 164,000 megawatts and operates a wholesale electricity market with more than 560 companies that are eligible to transact in the markets PJM administers. PJM enables the delivery of electric power to more than 51 million people in all or parts of Delaware, Illinois, Indiana, Kentucky, Maryland, Michigan, New Jersey, North Carolina, Ohio, Pennsylvania, Tennessee, Virginia, West Virginia and the District of Columbia.

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

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

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

PJM EnviroTrade, Inc. (PJM ET) is a wholly-owned subsidiary of PJM Tech formed as a market platform for environmental transactions. PJM ET was incorporated on January 5, 2010, and is not a FERC-regulated entity. PJM ET is expected to commence full operations during June 2010.

## Tariff Cost Recovery

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

The first component is a composite rate. The tariff establishes a four-step rate structure. Beginning June 1, 2007, the composite rate was 32 cents per megawatt-hour (MWh); beginning January 1, 2008, 31 cents per MWh; and beginning January 1, 2011, 30 cents per MWh. In 2010, PJM management and the member-elected PJM Finance Committee may discuss whether the rate level in the fourth step needs to be adjusted to ensure recovery of PJM's costs.

The second element is a rider for the Advanced Second Control Center (AC<sup>2</sup>). The tariff establishes a specific mechanism for PJM to collect from its customers the actual costs to construct and operate AC<sup>2</sup>. The recovery of those costs is from a formula rate set forth in a separate schedule in the PJM Open Access Transmission Tariff (Tariff). The recovery is capped at the capitalized investment costs and operating costs of AC<sup>2</sup>. The rider will remain in effect until seven years from the in-service date of the AC<sup>2</sup> energy management system, which is projected to be during 2010. In June 2008, PJM placed into service certain assets at the AC<sup>2</sup> facility. PJM began to recover costs under this rider in July 2008. During 2009 and 2008, \$5.3 million and \$2.1 million were billed under this rider, respectively.

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

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

## Critical Accounting Policies

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

## Deferred Recovery of Pension and Postretirement Costs

The Company recognizes the overfunded or underfunded projected benefit obligation (PBO) of a defined benefit pension plan as an asset or liability in the balance sheet. The PBO represents the actuarial present value of benefits attributable to employee service rendered to date, including the effects of estimated future salary increases. In addition to recording the underfunded PBO as a liability, PJM has recorded a regulatory asset pursuant to FASB guidance on accounting for the effects of certain types of regulation (ASC 980) to reflect the underfunded PBO related to PJM's defined benefit plans because of the anticipated future recovery of these costs through the Company's rate structure. This asset will be amortized each quarter as the net periodic benefit cost of the underfunded liability is recognized. The deferred recovery of pension and postretirement costs at December 31, 2009 and 2008, were \$11.0 million and \$26.8 million, respectively.

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## Deferred FERC Fees and Deferred FERC Fee Liability

The FERC charges an annual assessment to all public utilities based on kilowatt-hours of interstate transmission service provided. Deferred FERC fees result from PJM's fixed-rate tariff schedule for recovery from PJM's members of annual charges from the FERC. At December 31, 2009, PJM had a \$1.3 million deferred FERC fee asset that will be billed to PJM's members during 2010. PJM did not record a deferred fee asset or liability at December 31, 2008, because collections equaled the charges assessed by the FERC for 2008.

## Deferred Regulatory Liability

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

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

On January 31, 2008, PJM filed with the FERC a proposal to accelerate the stated rate refund mechanism for deferred regulatory liabilities accumulating in 2008 and forward. The FERC approved this proposal on March 12, 2008, with an effective date of April 1, 2008. Beginning in 2009, the original refund mechanism was discontinued. PJM now refunds on a quarterly basis the deferred regulatory liability balance in excess of six percent of the annual revenue threshold. The quarterly refund rate is established after the financial close of each quarter and refunds are distributed to the members on a prospective basis in the following quarter. For the year ended December 31, 2009, PJM made refunds of \$72.8 million. The increase in refunds is primarily attributable to an income tax benefit recorded during the second quarter of 2009. This benefit was a result of the Company releasing valuation allowances on certain deferred tax assets. See Note 11 of the financial statements for further discussion.

There will not be a prior period adjustment; any under- or overrefund amounts will be reflected in the deferred regulatory liability balance in the following quarter. In 2011 and every third year thereafter, refunds will not reduce the non-current liability balance below \$6 million.

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

At December 31, 2009, the deferred regulatory liability was \$20.8 million. At December 31, 2008, the deferred regulatory liability was \$28.7 million. At December 31, 2009 and December 31, 2008, the current portion of the deferred regulatory liability was \$7.1 million and \$14.4 million, respectively. The current balance at December 31, 2009 represents the amount to be refunded to members in the first quarter of 2010. The non-current portion of the deferred regulatory liability of \$13.7 million and \$14.3 million represents the amount of PJM's reserve at December 31, 2009 and December 31, 2008, respectively.

## Benefit Plan Accounting

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

In addition to requiring employers to recognize the overfunded or underfunded PBO of a defined benefit pension plan as an asset or liability in the balance sheet, the FASB guidance also requires employers to recognize annual changes in gains or losses, prior service costs or other credits that have not been recognized as a part of the liability in the Consolidated Statement of Financial Position. The Company adopted the FASB guidance, which established a new framework for accounting for Deferred Benefit Pension and Postretirement Plans for the year ended December 31, 2007. FASB guidance on Regulated Operations (ASC 980) requires that a corresponding regulatory asset, Deferred Pension and Postretirement Costs, be included in the Consolidated Statement of Financial Position.

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

In selecting the discount rate assumption for the PJM retirement plan at December 31, 2009, the Company selected a method that matches projected payouts from the plan with a yield curve that was produced from a universe containing over 500 U.S.-issued Aa-rated corporate bonds, all of which were noncallable (or callable with make-whole provisions), and excluding the 10 percent of the bonds with the highest yields and the 10 percent with the lowest yields. The discount rate was then developed as a level equivalent rate that would produce the same present value as would result using spot rates to discount the projected pension benefit payments. Based on this analysis, the discount rate for its pension plan remained at 6.10 percent at December 31, 2009. The discount rate increased to 6.30 percent for the postretirement healthcare plan.

In selecting an expected return on plan assets, PJM considers past performance and economic forecasts for the types of investments held by the plans. At December 31, 2009, the expected return on plan assets decreased to 7.50 percent from 7.75 percent at December 31, 2008.

The rate of compensation increase assumption remained at 4.50 percent at December 31, 2009.

In selecting healthcare cost trend rates, PJM considers past performance and forecasts of healthcare costs. The rate used for 2009 was 9.25 percent, declining to 5.00 percent over six years.

Changes in the assumptions listed above could have a significant impact on the accrued pension and other postretirement benefit liabilities and reported annual net periodic pension and other postretirement benefit costs. For example, the effect of a 1 percent increase in the assumed healthcare cost trend rate from 9.25 percent to 10.25 percent would increase the postretirement benefit obligation as of December 31, 2009 by \$6.8 million and the current year postretirement benefit cost by approximately \$1.2 million. A 1 percent decrease in the assumed healthcare cost trend rate from 9.25 percent to 8.25 percent would decrease the accumulated postretirement benefit obligation by approximately \$5.4 million and would decrease the postretirement benefit cost by approximately \$0.9 million annually.

During 2009, PJM expensed net periodic pension and other postretirement benefit costs of \$12.6 million. This amount represents a \$1.9 million increase in expense compared with the amount recognized during 2008. This increase was primarily due to higher pension expense based on the lower asset performance in the prior year.

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## Fixed Asset Capitalization

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

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

## Income Tax Accounting

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

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

## Study and Interconnection Activity

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

## Results of Operations for 2009, 2008, 2007

### Revenues

Total revenues decreased \$26.4 million, or 11 percent, from 2008 to 2009, compared with a decrease of \$21.5 million, or 8 percent, from 2007 to 2008. Changes in service fees and interest income were the primary drivers of this decrease.

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

Interest income was \$16.2 million, or 80 percent, lower in 2009 than in 2008 due to declining interest rates and lower deposit and operating cash balances. Interest income primarily represents interest on customer deposits, which is credited back to members that have customer deposits through interest expense. The decreases are due to lower cash and deposit balances on hand, resulting principally from accelerating billing settlements from monthly to weekly and declining interest rates.

PJM's service fees decreased \$7.2 million, or 3 percent, to \$240.4 million from 2007 to 2008. The decline is primarily attributable to a decline in composite stated rates from 32 cents per MWh in 2007 to 31 cents per MWh in 2008. Transmission volumes for 2008 were 759 TWhs as compared with 764 TWhs for 2007.

Deferred regulatory income represents PJM's stated rate tariff service fees in excess of expenses and is an offset to total revenues. In 2008, the increase in the deferred regulatory income represented \$10.7 million of the decline in total revenues for 2008.

Interest income was \$9.0 million, or 31 percent, lower in 2008 than in 2007 due to declining interest rates. Interest income primarily represents interest on customer deposits, which is credited back to members that have customer deposits through interest expense.

PJM EIS began billing customers in September 2005 for the Generation Attributes Tracking System reporting services. Net income from PJM EIS was \$0.7 million in 2009 and 2008.

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## Expenses

The following table summarizes the percentage of total expenses, excluding study and interconnection services, interest expense and income taxes, for the years ended December 31, 2009, 2008 and 2007:

Year Ended December 31,	2009	2008	2007
Compensation expense	38	38	34
Depreciation and amortization expense, net	8	7	15
Outside services	18	19	18
FERC fees	17	17	15
Pension and postretirement benefit expenses	5	5	6
Computer maintenance and office supplies	3	3	3
Software licenses and fees	4	4	4
Lease expenses	2	2	1
Other expenses	5	5	4
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

Total expenses, excluding study and interconnection services, interest expense and income taxes, increased \$13.5 million, or 6 percent, to \$232.1 million in 2009 as compared with a decrease of \$11.2 million, or 5 percent, in 2008. The increase in 2009 resulted primarily from the following factors: (1) a \$3.8 million increase in net depreciation and amortization expense due to certain AC<sup>2</sup> assets and member billing systems being placed into service; (2) a \$2.0 million increase in retirement plan expenses principally resulting from lower asset performance in 2008; and, (3) a \$2.0 million increase in FERC fees. For the years ended December 31, 2009 and 2008, outside services included amounts paid to PJM's independent auditor, PricewaterhouseCoopers LLP, totaling \$1.2 million and \$1.1 million, respectively, which were predominantly for audits of the PJM Consolidated Financial Statements and audits of certain internal control systems in accordance with Statement on Auditing Standards No. 70.

Key information systems, system enhancements and capital investments completed by PJM in 2009 included:

- **Accelerated Market Settlements System**, providing the technology to calculate and issue weekly bills to members more efficiently.
- **AC<sup>2</sup> Milford Facility**, the remainder of this facility (data center and control center) was placed into service during 2009.
- **Demand-Side Response Enhancement**, providing a system to demand-side participants as a data repository and to provide tracking of transactions. The new system also calculates customer base load and manages meter data.

Total expenses, excluding study and interconnection services, interest expense and income taxes, decreased \$11.2 million, or 5 percent, to \$218.6 million in 2008 as compared with a decrease of \$6.3 million, or 3 percent, in 2007. The decrease in 2008 resulted primarily from a \$19.2 million decrease in net depreciation and amortization expense associated with lower capital projects being placed into service in 2006 and 2007 as compared with prior periods and elimination in 2008 of depreciation charges that had been deferred from earlier periods but were reflected in 2007. This decrease was partially offset by a \$3.9 million increase in FERC fees. Depreciation and amortization charges will increase once the second control center is complete and the facility and related systems are fully placed into service. For the years ended December 31, 2008 and 2007, outside services included amounts paid to PJM's independent auditor, PricewaterhouseCoopers LLP, totaling \$1.1 million and \$1.0 million, respectively, which were predominantly for audits of the PJM Consolidated Financial Statements and audits of certain internal control systems in accordance with Statement on Auditing Standards No. 70.

## Billings for Services

Membership increased to 564 members at December 31, 2009, as compared with 554 members at December 31, 2008. The billings presented below are administered on behalf of the members; however, the associated revenues, expenses, receivables and payables are presented net in PJM's Consolidated Statement of Income, Comprehensive Income and Paid in Capital, Retained Earnings and Accumulated Other Comprehensive Income. The only billings included in PJM's financial statements are PJM Scheduling, System Control and Dispatch, Advanced Second Control Center Costs and FERC Annual Charge Recovery. For 2009, 2008 and 2007, settlements processed by PJM under the Tariff, Operating Agreement and Reliability Assurance Agreement were as follows:

(\$ in millions)	2009 Amount Billed	2008 Amount Billed	2007 Amount Billed
Energy Markets	\$ 11,163.1	\$ 18,658.2	\$ 20,196.3
Transmission Congestion	784.6	2,222.4	1,832.3
PJM Scheduling, System Control and Dispatch (Operating Expense Reimbursement, net of stated rate refunds)	150.3	157.8	247.6
Advanced Second Control Center Costs	5.3	2.1	–
Market Monitoring Unit Funding	9.3	4.1	–
RTO Scheduling, System Control and Dispatch (Transmission Owners' Control Center Expenses)	56.6	61.8	62.0
Reactive Supply	239.5	219.9	193.8
Regulation Market	228.3	487.8	450.7
Spinning Reserve Market	31.7	55.0	41.6
Day-Ahead Scheduling Reserve Market	8.4	3.3	–
Operating Reserves	323.5	463.8	478.5
Black Start Service	14.3	15.7	15.2
Network Transmission Service	1,289.3	1,313.0	1,170.3
Point-to-Point Transmission Service	63.2	94.7	68.3
Capacity	8,752.4	6,720.8	3,291.9
Transmission Enhancement	164.2	50.8	4.1
Expansion Cost Recovery and RTO Startup Cost Recovery	9.1	9.1	8.9
FERC Annual Charge Recovery	39.6	31.3	33.5
Seams Elimination Cost Assignment (SECA)	–	4.2	14.3
Generation Deactivation	5.9	30.6	48.0
Transmission Losses (Point-to-Point)	1,267.6	1,309.4	647.6
FTR Auction Revenues	1,902.2	2,258.0	1,668.3
Distribution Facilities	20.6	20.1	17.7
Ramapo PAR (Phase Angle Regulator) Facilities	1.4	1.4	1.8
Load Response Program	1.9	31.2	47.7
Unscheduled Transmission Service	0.1	1.3	0.7
Organization of PJM States, Inc. (OPSI) Fees	0.4	0.4	0.1
North American Electric Reliability Corporation (NERC)	4.5	3.6	3.2
ReliabilityFirst Corporation (RFC)	5.7	6.3	6.2
Emergency Energy	–	–	0.1
Customer Default Allocation Assessments	5.3	63.4	4.6
Miscellaneous	3.0	2.4	0.2
<b>Total</b>	<b>\$ 26,551.3</b>	<b>\$ 34,303.9</b>	<b>\$ 30,555.5</b>

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## Liquidity and Capital Resources

Under the stated rate tariff, PJM collected 31 cents per MWh in 2009 and will collect 31 cents per MWh until January 1, 2011 on a composite basis. In 2009, the accumulated financial reserve was \$20.8 million, \$7.1 million of which will be refunded to members during the first quarter of 2010. PJM is projected to refund \$29 to \$33 million to members during 2010, which would result in an accumulated financial reserve balance of \$21 million at December 31, 2010.

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

PJM has a \$50 million revolving line of credit agreement that expires in April 2011. Additionally, PJM has a \$110 million project development facility that expires in April 2011 and for which borrowings are collateralized by all of PJM's tangible and intangible property other than the assets acquired pursuant to the Facilities Agreement with a subset of PJM's members. At December 31, 2009, PJM had no outstanding borrowings on both the working capital line of credit facility and the project development facility. FERC approval for borrowings under these facilities must be requested biennially.

On March 31, 2009, the FERC approved PJM's application to enter into a \$35 million loan agreement with PNC Bank. The loan has a seven-year term and is secured by the AC<sup>2</sup> property in Milford, PA. The closing on this loan facility occurred on April 30, 2009. At December 31, 2009, outstanding borrowings were \$33.6 million. PJM is expected to pay \$2.3 million of principal payments during 2010.

On March 28, 2008, the FERC approved PJM's application to borrow up to \$115 million under a private placement master note agreement. On September 15, 2009, PJM issued senior unsecured notes with a seven-year term totaling \$75 million under this facility. At December 31, 2009, outstanding borrowings were \$75 million. The purpose of this borrowing is to fund the technology investment in AC<sup>2</sup>. PJM is expected to pay \$5.8 million of principal payments during 2010.

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

As of December 31, 2009 and 2008, PJM was assigned an Aa3 issuer rating by Moody's Investors Service.

For study and interconnection work performed, PJM obtains liquid collateral from the transmission customer for the estimated costs of the transmission system modifications. PJM's study and interconnection receivables are comprised of billings to transmission customers for services performed under these interconnection service agreements. PJM's study and interconnection payables represent amounts due to the transmission owners for services performed under these interconnection service agreements. PJM held deposits related to study and interconnection activity totaling \$53.7 million and \$46.9 million at December 31, 2009 and 2008, respectively.

PJM requires deposits from various parties in connection with services to be performed or as collateral for market activity. PJM held credit deposits of \$493.6 million and \$834.4 million at December 31, 2009 and 2008, respectively. These deposits are maintained in separate cash accounts that are not legally restricted. The decline in deposits during 2009 is principally attributable to PJM implementing weekly settlement of member billing in June 2009.

Cash and cash equivalents are derived from operations and from financing activities. Net cash used in operating activities in 2009 was \$10.5 million, compared with \$30.0 million in 2008. The change in cash used in operations is primarily a result of tax benefits resulting from changes to the Company's postretirement medical plan that were refunded to members during 2009. Specifically, PJM reversed the valuation allowance against the deferred tax asset related to PJM's postretirement medical plan. PJM members received a refund for the resulting income tax benefit, but PJM has not yet received refunds from the Internal Revenue Service for this benefit. PJM anticipates receiving \$8.0 million in federal tax refunds during 2010. The remaining tax refunds related to this adjustment are not expected to be received until after 2010.

Net cash used in financing activities was \$268.9 million in 2009 as compared with net cash provided by financing activities of \$374.8 million in 2008. The difference is primarily due to lower customer deposits because of the Company's movement to weekly settlement of member obligations as compared to monthly. This movement has decreased the amount of collateral required under the Company's credit policy. This decrease was partially offset by loan proceeds from two long-term facilities closed during 2009.

For 2010, PJM's Board of Managers has approved a capital budget, excluding the second control center, of \$30 million. These capital expenditures will be used for application replacements, system reliability applications, new products and services for PJM's membership, risk management and interregional coordination. PJM is anticipating capital expenditures to be incurred through 2010 of approximately \$143 million for the development of a second control center, approximately \$113 million of which had been spent through December 31, 2009. Actual expenditures may differ from these amounts as PJM continues to assess its capital needs.

During 2008, PJM entered into a loan agreement with Monitoring Analytics LLC (MA), an external firm tasked with monitoring the markets PJM administers, to fund its start-up expenditures. The loan is secured by MA's accounts receivable and future collections of accounts receivable. At December 31, 2009, the outstanding note receivable was \$3.4 million.

## Risks and Uncertainties

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

## Recent Regulatory Actions

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

On May 21, 2007, ConEd filed a Petition for Rehearing of the FERC's April 20, 2007 Order. PSEG and ConEd filed appeals with the D.C. Circuit Court of Appeals on June 18, 2007, and June 19, 2007, respectively. On February 23, 2009, the parties to the complaint filed with the FERC a settlement offer to resolve all issues in this matter pending at the FERC and in the D.C. Circuit Court of Appeals. The settlement, if approved by the FERC, would provide "rolled over" service between ConEd and PSEG in accordance with transmission service agreements between PJM and ConEd and joint operating protocols between PJM and the NYISO. The filed settlement was contested. On February 19, 2010, the FERC found that they were unable to approve the settlement because the current state of the record does not permit them to resolve the merits of some of the contested issues. Because these issues must be addressed before determining whether the settlement can be approved, the FERC will require the parties to brief these issues. The outcome of this matter is not anticipated to have any material adverse impact on PJM's financial position, results of operations or cash flow.

On May 30, 2008, 18 PJM Members, calling themselves the Reliability Pricing Model (RPM) Buyers filed with the FERC a complaint against PJM asking the FERC to find that PJM's RPM, as implemented through the "transitional" base residual auctions, has produced unjust and unreasonable capacity prices and to order refunds from the PJM members that received RPM revenues. PJM filed its answer on July 11, 2008, requesting that the FERC dismiss the complaint because the requested relief violates the filed rate doctrine, represents a collateral attack on the FERC's prior RPM orders and is contrary to the FERC's policy not to order the re-running of markets. The FERC dismissed the RPM Buyers' complaint on September 19, 2008. On October 20, 2008, the RPM Buyers filed a request for rehearing at the FERC on this matter. On November 18, 2008, the FERC issued an order granting rehearing for further consideration for the limited purpose of giving itself additional time to consider the matters raised in the RPM Buyers' request for rehearing. Thereafter, the FERC issued an order on June 18, 2009, denying the RPM Buyers' request for rehearing, denying their request for oral argument and reaffirming its September 19, 2008 order dismissing their complaint filed against PJM. On August 14, 2009, two of the 18 RPM Buyers, the Maryland Public Service Commission and New Jersey Board of Public Utilities, filed a Petition

# Financial Report

for Review and Notice in the Fourth Circuit Court of Appeals to appeal the FERC's September 19, 2008 and June 18, 2009 orders. On November 12, 2009, an order was granted transferring the matter to the U.S. Court of Appeals for the District of Columbia Circuit Court. PJM cannot predict the outcome of this matter, but does not foresee any material adverse impact on PJM's operations or financial position.

On June 26, 2009, PJM reported to the FERC that it discovered a Market Flow modeling discrepancy, which affected the calculation of market-to-market coordination payments under the Joint Operating Agreement (JOA) between PJM and the Midwest Independent Transmission System Operator, Inc. (Midwest ISO). As a result of this discrepancy, the market-to-market coordination payments from PJM to the Midwest ISO have been significantly underpaid. The discrepancy has been rectified going forward, and PJM and Midwest ISO are working together to quantify the past underpayment. PJM and Midwest ISO were able to reach agreement on a methodology to calculate and quantify the impact of the error for the years 2007-2009, which resulted in an estimated error of approximately \$65 million for those two years. The RTOs, however, could not agree on a method to calculate the impact of the error for the years 2005-2007, how far back the recalculation should go or the application of the JOA's limitation of liability provisions. Furthermore, PJM is investigating potential errors by Midwest ISO in use of market-to-market coordination, which may offset any amounts owed to Midwest ISO by PJM. Thus, PJM and Midwest ISO initiated alternative dispute resolution under the JOA in September 2009. On September 15, 2009, this dispute was submitted to the FERC for dispute resolution by a settlement judge. The first settlement conferences were held on October 19 and October 20, 2009. Additional settlement conferences were held on December 10 and 11, 2009. The settlement proceedings continue and additional settlement conferences were held in February 2010. On March 8, 2010, the Midwest ISO filed two complaints against PJM with the FERC. The first complaint is seeking damages in the amount of \$130 million plus interest for the market flow modeling discrepancy for the period 2005 - June 2009. The second complaint alleges that PJM is in violation of the JOA because PJM allegedly demanded resettlement of amounts related to the Midwest ISO's use of substitute flowgates in the market-to-market processes under the JOA. The Midwest ISO has asked the FERC to order PJM to acknowledge the use of substitute flowgates under the JOA. The Midwest ISO is seeking reimbursement of \$5 million under the second complaint. A formal response on both matters is due March 29, 2010. PJM cannot predict the outcome of this matter, but does not foresee any material adverse impact on PJM's operations or financial position.

## Other Items

At December 31, 2009, PJM had a receivable due from the Midwest ISO of \$33.4 million for Seams Elimination Cost Adjustments (SECA) billed for the 11 months ended March 31, 2006. While the Midwest ISO has billed Green Mountain Energy Trading (Green Mountain), the Midwest ISO customer responsible for the unpaid SECA charges, it has not yet received payment from that customer. The PJM transmission owners filed a motion on January 26, 2006, asking the FERC to use its civil enforcement powers to compel the defaulting Midwest ISO customer to comply with the Midwest ISO tariff and pay its allocated SECA charges. On September 26, 2008, PJM, the Midwest ISO and the RTOs' Transmission Owners filed a joint motion requesting the Commission to expeditiously act on the SECA matters pending before the Commission in the SECA proceeding as follows (i) approve the filed settlements; (ii) rule on two Initial Decisions issued by the presiding Administrative Law Judge; and (iii) grant the pending motions to enforce the orders, contracts and tariff requirements pursuant to which the Midwest ISO assessed against Green Mountain. This matter remains outstanding. The receivable from Midwest ISO is offset by the \$33.4 million payable by PJM to market participants for these SECA credits. Consequently, on a net basis, there are no amounts reported in the Consolidated Statement of Financial Position related to these items. Although PJM management cannot determine the impact, if any, of the final disposition of the amounts not yet collected by Midwest ISO from its market participants, the resolution will not have any impact on PJM's results of operations as PJM's Tariff only obligates PJM to disburse to its members the actual SECA charges collected.

## Legislative Activity

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

## Third-Party Relationships

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

# Financial Report

## Credit Risks

PJM bills and collects its operating expenses monthly from its members. Payment of all operating expense bills is due from PJM's members monthly. During 2009, approximately 70 percent of PJM's operating expenses were billed to 17 of its 564 members, each of which either have an investment-grade credit rating or have provided a guaranty from an affiliate with an investment-grade rating. In the event of default of any PJM members, PJM has the right to bill the remaining PJM members a ratable portion of the operating expenses previously billed to the defaulting member.

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

On March 7, 2008, PJM filed a complaint with the FERC against Power Edge and its affiliates (collectively the Tower Affiliates) that transacted in the PJM markets alleging market manipulation, fraudulent distribution of Tower Affiliates' funds and fraudulent nonpayment of bills. In its complaint, PJM requested that the FERC order a public investigation, disgorgement of unjust revenues and profits of Power Edge and its affiliates, civil penalties and a bar on participation of Power Edge and its affiliates in PJM's markets. The Tower Affiliates filed an answer to PJM's complaint on March 27, 2008, and on April 30, 2008, the FERC issued an order holding the complaint in abeyance pending the completion of the FERC Office of Enforcement's investigation.

On March 28, 2008, the Tower Affiliates filed a complaint against PJM at FERC alleging that PJM was in violation of its Tariff by retaining collateral and revenues that they alleged should be paid to the Tower Affiliates. The Tower Affiliates requested that the FERC order PJM to remit to them \$11.0 million of collateral and \$14.7 million of net revenues plus interest. On April 17, 2008, PJM filed a response to the Tower Affiliates' complaint requesting that the FERC deny Tower Affiliates' request and allow PJM to retain the collateral and net revenues of Tower Affiliates until the FERC has completed its investigation into PJM's March 7, 2008 complaint and the civil complaint described below has been resolved. On April 2, 2009, the FERC issued an order directing PJM to return all collateral funds and trading revenues being held to the Tower Affiliates within 120 days. On April 15, 2009, PJM filed a request for clarification or rehearing in connection with this FERC order. Notwithstanding such request, pursuant to the FERC order, PJM returned \$37 million to Tower Affiliates on July 31, 2009, representing all collateral funds and trading revenues previously held. On August 21, 2009, the Tower Affiliates filed a protest at FERC, seeking an additional \$1.6 million of interest. On October 2, 2009, the FERC issued an order, directing PJM to pay the Tower Affiliates additional interest, in the amount of \$0.8 million. PJM paid such amount to the Tower Affiliates on October 19, 2009. The October 2, 2009 order additionally provided PJM its requested clarification that it is free to pursue its common law and civil actions in federal court.

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

On July 2, 2008, the Tower Affiliates filed a civil complaint against PJM in the Philadelphia County, Pennsylvania, Court of Common Pleas seeking return of the funds being withheld by PJM and compensatory and punitive damages for alleged interference with the Tower Affiliates' business relationships and defamation. PJM subsequently was able to remove the case to the United States District Court for the Eastern District of Pennsylvania (the Pennsylvania Case). On June 12, 2009, pursuant to an order of the U.S. District Court for the District of Delaware, the Delaware Case was transferred to the U.S. District Court for the Eastern District of Pennsylvania where, on July 13, 2009, it was consolidated with the Pennsylvania Case. PJM believes the Tower Affiliates' claims are without merit, and intends to vigorously defend against such claims.

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

On September 18, 2009, PJM filed Proofs of Claim, along with supporting documentation, with the Bankruptcy Court setting forth PJM's creditor claim against both LBCS and LBHI.

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

# Financial Report

## Management's Responsibility for Financial Reporting

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

PJM's management also is responsible for the preparation of other information in this annual report and for its accuracy and consistency with the financial statements.

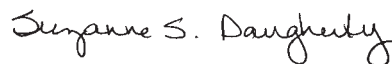
PJM has established a system of internal accounting and financial controls and procedures designed to provide reasonable assurance as to the integrity and reliability of financial reporting. Management continually reviews the effectiveness and efficiency of this system and takes actions when opportunities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

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

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



Terry Boston  
President & Chief Executive Officer



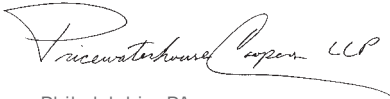
Suzanne S. Daugherty  
Vice President, Chief Financial Officer & Treasurer

## Report of Independent Auditors

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

In our opinion, the accompanying consolidated statements of financial position and the related consolidated statements of income, comprehensive income and paid in capital, retained earnings and accumulated other comprehensive income and of cash flows present fairly, in all material respects, the financial position of PJM Interconnection, L.L.C. and its subsidiaries (the "Company") at December 31, 2009 and 2008, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2009, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 11 to the consolidated financial statements, the Company changed the manner in which it accounts for uncertain tax positions in 2008.



Philadelphia, PA  
March 8, 2010

# Financial Report

## Consolidated Statement of Financial Position

(\$ in thousands)	December 31,	
	2009	2008
<b>Assets</b>		
Current assets:		
Deposits on hand	\$ 547,349	\$ 881,296
Operating cash	47,665	57,550
Receivables	7,725	4,981
Study and interconnection receivables	16,637	4,476
Deferred FERC fees	1,338	-
Prepaid taxes	9,380	5,186
Prepaid expenses and other	5,393	4,645
Deferred income taxes, net of valuation allowance	4,649	1,552
	640,136	959,686
Non-current assets:		
Fixed assets, net of accumulated depreciation and amortization of \$314,454 and \$295,504	79,534	63,791
Land	1,420	956
Projects in development	90,826	64,016
Deferred recovery of pension and postretirement costs	11,041	26,849
Deferred income taxes, net of valuation allowance	19,625	2,584
Note receivable	3,428	4,690
Other	1,112	836
	206,986	163,722
<b>Total assets</b>	<b>\$ 847,122</b>	<b>\$ 1,123,408</b>
<b>Liabilities, paid in capital, retained earnings and accumulated other comprehensive income</b>		
Current liabilities:		
Accounts payable and accrued expenses	\$ 26,862	\$ 39,015
Member prepayment	21,510	44,069
Study and interconnection payables	22,869	5,826
Accrued payroll and benefits	19,371	15,417
Revolving line of credit	-	20,000
Current portion of long-term debt	8,103	-
Current portion of non-recourse debt	-	311
Deferred regulatory liability	7,050	14,366
Deferred revenue	1,914	1,853
Postretirement healthcare benefits liability	442	1,024
Other employee benefits	346	52
Deposits	547,349	881,296
	655,816	1,023,229
Non-current liabilities:		
Non-recourse debt	-	735
Long-term debt	100,537	-
Deferred regulatory liability	13,703	14,299
Interest rate swap	131	-
Pension benefits liability	29,147	30,378
Postretirement healthcare benefits liability	41,375	49,737
Other employee benefits	3,331	2,764
	188,224	97,913
<b>Total liabilities</b>	<b>844,040</b>	<b>1,121,142</b>
Commitment and contingencies (Note 13)		
Paid in capital	722	722
Retained earnings	1,936	1,248
Accumulated other comprehensive income	424	296
<b>Total paid in capital, retained earnings and accumulated other comprehensive income</b>	<b>3,082</b>	<b>2,266</b>
<b>Total liabilities, paid in capital, retained earnings and accumulated other comprehensive income</b>	<b>\$ 847,122</b>	<b>\$ 1,123,408</b>

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

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

For the Years Ended December 31,

(\$ in thousands)	2009	2008	2007
<b>Income</b>			
Revenue:			
Service fees	\$ 228,385	\$ 240,422	\$ 247,609
Deferred regulatory income	(64,840)	(63,143)	(52,414)
FERC fees reimbursement	39,590	37,473	33,585
Study and interconnection fees	3,453	2,814	1,840
Interest income	4,112	20,266	29,246
Membership fees	2,059	1,883	1,542
Other income	2,201	1,631	1,455
<b>Total revenue</b>	<b>214,960</b>	<b>241,346</b>	<b>262,863</b>
Expenses:			
Compensation	89,017	83,971	79,118
Depreciation and amortization, net of deferral recovery	18,996	15,181	34,409
Outside services	40,095	40,877	41,766
FERC fees	39,590	37,473	33,585
Pension benefits	6,903	4,106	6,838
Postretirement healthcare benefits	5,684	6,564	6,948
Computer maintenance and office supplies	7,979	7,203	6,756
Software licenses and fees	9,882	9,119	7,659
Lease expenses	2,826	2,994	2,922
Study and interconnection services	3,453	2,814	1,840
Other expenses	11,174	11,145	9,866
Interest expense	5,637	18,023	25,148
<b>Total expenses</b>	<b>241,236</b>	<b>239,470</b>	<b>256,855</b>
(Loss) income before income taxes	(26,276)	1,876	6,008
Income tax (benefit) expense	(26,964)	1,224	5,446
<b>Net income</b>	<b>\$ 688</b>	<b>\$ 652</b>	<b>\$ 562</b>
Other comprehensive income (loss):			
Unrealized gain (loss) on securities, net	128	(115)	50
<b>Comprehensive income, net</b>	<b>\$ 816</b>	<b>\$ 537</b>	<b>\$ 612</b>
<b>Paid in capital, retained earnings and accumulated other comprehensive income</b>			
Beginning balance	\$ 2,266	\$ 1,729	\$ 1,117
Net income	688	652	562
Comprehensive income (loss)	128	(115)	50
<b>Ending balance</b>	<b>\$ 3,082</b>	<b>\$ 2,266</b>	<b>\$ 1,729</b>

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

# Financial Report

## Consolidated Statement of Cash Flows

For the Years Ended December 31,

(\$ in thousands)	2009	2008	2007
<b>Cash flows from operating activities:</b>			
Net income	\$ 688	\$ 652	\$ 562
<b>Adjustments:</b>			
Depreciation and amortization expense	18,996	15,181	30,289
Deferred depreciation and amortization	-	-	4,120
Deferred income taxes, net of valuation allowance	(20,138)	2,033	(1,333)
Deferred recovery of pension and postretirement costs	15,808	(17,925)	(8,924)
Deferred regulatory liability	(7,912)	(38,271)	45,915
Employee benefit expense (less than) greater than funding	(9,314)	23,716	13,534
Net fair value changes related to interest rate swap	131	-	-
<b>Changes in assets and liabilities:</b>			
(Increase) decrease in receivables	(2,744)	20,528	1,376
(Increase) decrease in study and interconnection receivables	(12,161)	(94)	1,323
(Increase) decrease in prepaid expenses and other	(942)	349	(1,718)
(Increase) in prepaid income taxes	(4,194)	(811)	(1,171)
(Decrease) increase in accounts payable and accrued expenses	(8,466)	(33,356)	37,280
(Decrease) in accrued income taxes	-	-	(3,435)
Increase (decrease) in study and interconnection payables	17,043	1,243	(1,392)
Increase (decrease) in accrued payroll and benefits	3,954	2,675	(1,011)
(Decrease) in deferred FERC fee liability	-	(6,133)	(1,060)
(Increase) in deferred FERC fees	(1,338)	-	-
Increase in deferred revenue	61	175	275
Net cash (used in) provided by operating activities	(10,528)	(30,038)	114,630
<b>Cash flows (used in) investing activities:</b>			
Cost of projects in development	(65,654)	(58,659)	(45,812)
Note receivable	1,262	(4,690)	-
Net cash (used in) investing activities	(64,392)	(63,349)	(45,812)
<b>Cash flows from financing activities:</b>			
Borrowings under line of credit	269,000	20,000	-
Repayments under line of credit	(289,000)	-	-
Repayments of long-term debt	(1,360)	-	(5,857)
Borrowings under long-term debt	110,000	-	-
Repayments under long-term project debt	-	(967)	(11,610)
Repayments under non-recourse debt	(1,046)	(444)	(488)
Member prepayment received	21,510	44,069	-
Member prepayment utilized	(44,069)	-	-
(Decrease) increase in deposits	(333,947)	312,115	248,548
Net cash (used in) provided by financing activities	(268,912)	374,773	230,593
Net (decrease) increase in cash and cash equivalents	(343,832)	281,386	299,411
Cash and cash equivalents balance (including customer deposits), beginning of year	938,846	657,460	358,049
Cash and cash equivalents balance (including customer deposits), end of year	\$595,014	\$938,846	\$657,460
<b>Cash paid during the year for:</b>			
Interest	\$ 6,600	\$ 18,051	\$ 25,913
Taxes	1,455	1,921	11,026
<b>Noncash Activity:</b>			
Plant additions included in ending Accounts Payable and Accrued Expenses	\$ (3,687)	\$ (1,704)	\$ 7,202

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

## Notes to the Consolidated Financial Statements December 31, 2009 (\$ in tables in thousands)

### 1. Company Overview

#### Background

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

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

#### Nature of Operations

The Company currently coordinates a pooled generating capacity of more than 164,000 megawatts and operates wholesale electricity markets with more than 560 companies that are eligible to transact in the markets PJM administers. PJM enables the delivery of electric power to more than 51 million people in all or parts of Delaware, Illinois, Indiana, Kentucky, Maryland, Michigan, New Jersey, North Carolina, Ohio, Pennsylvania, Tennessee, Virginia, West Virginia and the District of Columbia.

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

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

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

#### Tariff Cost Recovery

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

The first component is a composite rate. PJM's Open Access Transmission Tariff (Tariff) establishes a four-step rate structure. Beginning June 1, 2007, the composite rate was 32 cents per megawatt-hour (MWh); beginning January 1, 2008, 31 cents per MWh; and beginning January 1, 2011, 30 cents per MWh. In 2010, PJM management and the member-elected PJM Finance Committee may discuss whether the rate level in the fourth step needs to be adjusted to ensure recovery of PJM's costs.

The second element is a rider for the Advanced Second Control Center (AC<sup>2</sup>). The Tariff establishes a specific mechanism for PJM to collect from its customers the actual costs to construct and operate AC<sup>2</sup>. The recovery of those costs is from a formula rate set forth in a separate schedule in the Tariff. The recovery is capped at the capitalized investment costs and operating costs of AC<sup>2</sup>. The rider will remain in effect until seven years from the in-service date of the AC<sup>2</sup> energy management system, which is projected to be during 2010. In June 2008, PJM placed into service certain assets at the AC<sup>2</sup> facility. PJM began to recover costs under this rider in July 2008. During 2009 and 2008, \$5.3 million and \$2.1 million were billed under this rider, respectively.

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

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

# Financial Report

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

### Basis of Presentation

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

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

The Financial Accounting Standards Board (FASB) has issued FASB Statement No. 168, The "FASB Accounting Standards Codification™" and the "Hierarchy of Generally Accepted Accounting Principles" (Codification). SFAS No. 168 establishes the FASB Accounting Standards Codification™ (ASC) as the single source of authoritative United States of America GAAP recognized by the FASB. Rules and interpretive releases of the Securities and Exchange Commission (SEC) under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. The Codification supersedes all existing non-SEC accounting and reporting standards. All other non-grandfathered, non-SEC accounting literature not included in the Codification will become non-authoritative.

Following the Codification, the FASB will not issue new standards in the form of Statements, FASB Staff Positions or Emerging Issues Task Force Abstracts. Instead, it will issue Accounting Standards Updates, which will serve to update the Codification, provide background information about the guidance and provide the basis for conclusions on the changes to the Codification.

GAAP is not intended to be changed as a result of the FASB's Codification project, but it will change the way the guidance is organized and presented. As a result, these changes will have a significant impact on how companies reference GAAP in their financial statements and in their accounting policies for financial statements issued for interim and annual periods ending after September 15, 2009. PJM has implemented the Codification in this report by providing references to the Codification topics alongside references to the ASC standards where applicable.

PJM has performed an evaluation of subsequent events through March 8, 2010, which is the date the financial statements were issued.

### Study and Interconnection Activity

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

### Cash Equivalents

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

### Concentration of Credit Risk

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

Under the terms of the PJM Operating Agreement, any payment defaults for which collection efforts are unsuccessful may be billed and collected from PJM's other member companies.

### Fixed Assets

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

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

### Deferred Recovery of Pension and Postretirement Costs

The Company recognizes the overfunded or underfunded projected benefit obligation (PBO) of a defined benefit pension plan as an asset or liability in the balance sheet. The PBO represents the actuarial present value of benefits attributable to employee service rendered to date, including the effects of estimated future salary increases. In addition to recording the underfunded PBO as a liability, PJM has recorded a regulatory asset pursuant to FASB guidance on accounting for the effects of certain types of regulation (ASC 980) to reflect the underfunded PBO related to PJM's defined benefit plans because of the anticipated future recovery of these costs through the Company's rate structure. This asset will be amortized each quarter as the net periodic benefit cost of the underfunded liability is recognized. The deferred recovery of pension and postretirement costs at December 31, 2009 and 2008, were \$11.0 million and \$26.8 million, respectively.

# Financial Report

## Deferred FERC Fees and Deferred FERC Fee Liability

The FERC charges an annual assessment to all public utilities based on kilowatt-hours of interstate transmission service provided. Deferred FERC fees result from PJM's fixed-rate tariff schedule for recovery from PJM's members of annual charges from the FERC. At December 31, 2009, PJM had a \$1.3 million deferred FERC fee asset that will be billed to PJM's members during 2010. PJM did not record a deferred fee asset or liability at December 31, 2008, because collections equaled the charges assessed by the FERC for 2008.

## Deferred Regulatory Liability

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

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

On January 31, 2008, PJM filed with the FERC a proposal to accelerate the stated rate refund mechanism for deferred regulatory liabilities accumulating in 2008 and forward. The FERC approved this proposal on March 12, 2008, with an effective date of April 1, 2008. Beginning in 2009, the original refund mechanism was discontinued. PJM now refunds on a quarterly basis the deferred regulatory liability balance in excess of six percent of the annual revenue threshold. The quarterly refund rate is established after the financial close of each quarter, and refunds are distributed to the members on a prospective basis in the following quarter. For the year ended December 31, 2009, PJM made refunds of \$72.8 million.

There will not be a prior period adjustment; any under- or overrefund amounts will be reflected in the deferred regulatory liability balance in the following quarter. In 2011 and every third year thereafter, refunds will not reduce the non-current liability balance below \$6 million.

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

At December 31, 2009, the deferred regulatory liability was \$20.8 million. At December 31, 2008, the deferred regulatory liability was \$28.7 million. At December 31, 2009 and December 31, 2008, the current portion of the deferred regulatory liability was \$7.1 million and \$14.4 million, respectively. The current balance at December 31, 2009 represents the amount to be refunded to members in the first quarter of 2010. The non-current portion of the deferred regulatory liability of \$13.7 million and \$14.3 million represents the amount of PJM's reserve at December 31, 2009 and December 31, 2008, respectively.

### Deferred Revenue

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

### Deposits

At December 31, 2009, the deposits balance was comprised of \$53.7 million received for study and interconnection fees and \$493.6 million held by PJM to support customer credit. At the end of 2008, PJM held deposits of \$46.9 million for study and interconnection fees and \$834.4 million for customer credit. These deposits are maintained in separate cash accounts that are not legally restricted.

### Income Taxes

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

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

# Financial Report

## Fair Values of Financial Instruments

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

## Benefit Plan Accounting

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

In addition to requiring employers to recognize the overfunded or underfunded PBO of a defined benefit pension plan as an asset or liability in the balance sheet, the FASB guidance also requires employers to recognize annual changes in gains or losses, prior service costs, or other credits that have not been recognized as a part of the liability in the Consolidated Statement of Financial Position. The Company adopted the FASB guidance, which establish a new framework for accounting for Deferred Benefit Pension and Postretirement Plans for the year ended December 31, 2007. FASB guidance on Regulated Operations (ASC 980) requires that a corresponding regulatory asset, Deferred Pension and Postretirement Costs be included in the Consolidated Statement of Financial Position.

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

The FASB issued new annual disclosure requirements about the fair value measurements and disclosures for plan assets of a defined benefit pension or other postretirement plan that are effective beginning with financial statements issued after December 15, 2009. The disclosures require entities to provide users an understanding of: (1) the investment allocation decisions made, (2) factors used in investment policies and strategies, (3) plan assets by major investment types, (4) inputs and valuation techniques used to measure the fair value of plan assets, (5) significant concentrations of risk within the plan, and (6) the effects of fair value measurement using significant unobservable inputs on changes in the value of plan assets for the period.

PJM has provided the new disclosures beginning with its December 31, 2009 financial statements in Note 12. Comparative disclosures are not required for earlier periods presented.

## Derivatives

Authoritative guidance on Derivative Instruments and Hedging Activities (ASC 815) enhances the disclosure requirements for derivative instruments and hedging activities. The new disclosure requirements include derivative objectives and strategies, derivative volumes by product type, location and gross fair values of derivative assets and liabilities, location and amounts of gains and losses on derivatives and related hedged items, and credit-risk-related contingent features in derivatives. This guidance was effective for financial statement reporting periods beginning January 1, 2009 for PJM. PJM has adopted these provisions with disclosures related to PJM's interest rate swap within Note 9.

## Revenue Recognition

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

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

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

### 3. Accounts Receivable

PJM's receivables at December 31, 2009 and 2008, consisted of the following:

	2009	2008
<b>Billed:</b>		
Membership fees	\$ 168	\$ 264
PJM EIS	514	335
	682	599
<b>Unbilled:</b>		
Service fees	6,923	4,282
PJM EIS	120	100
	7,043	4,382
	\$ 7,725	\$ 4,981

PJM's member companies are billed on a monthly basis for recovery of PJM's administrative costs under the Tariff. PJM bills members for services under eight distinct service categories.

All study and interconnection receivables were billed at December 31, 2009 and 2008.

### 4. Fixed Assets

A summary of fixed assets by classification as of December 31, 2009 and 2008, follows:

	2009	2008
Buildings	\$ 18,812	\$ 18,812
Leasehold improvements	32,348	17,009
Software development	275,688	260,260
Computer hardware	66,372	62,446
Furniture and fixtures	768	768
Subtotal	393,988	359,295
Accumulated depreciation and amortization	(314,454)	(295,504)
Total fixed assets, net of accumulated depreciation and amortization	\$ 79,534	\$ 63,791

Amortization of software development costs for the years ended December 31, 2009 and 2008 were \$11.8 million and \$9.3 million, respectively.

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

Total interest costs incurred for the year ended December 31, 2008, was \$18.2 million of which \$0.2 million attributable to assets under construction was capitalized.

# Financial Report

## 5. Note Receivable

On March 21, 2008, the FERC approved the settlement to restructure the relationship between PJM and PJM's former Market Monitoring Unit (MMU). As part of the settlement, the MMU and its functions transitioned from being an internal PJM department to an external firm, Monitoring Analytics, LLC (MA). MA operates independent of PJM management and Board of Managers oversight. In order to facilitate the externalization of this function and as part of the settlement agreement approved by the FERC, PJM entered into a loan agreement on March 14, 2008, with MA. The purpose of the loan is to fund capital needs associated with MA's initial technology systems and working capital needs related to MA's responsibilities per Attachment M of the Tariff to monitor the markets administered by PJM. The loan is secured by MA's accounts receivable and future collections of accounts receivable. The loan matures no later than 80 months from the date that MA begins providing services to PJM pursuant to the Market Monitor Services Agreement, which was effective August 1, 2008. At December 31, 2009 and December 31, 2008, the outstanding balance due from MA recorded by PJM as a note receivable was \$3.4 million and \$4.7 million, respectively.

## 6. Short-Term Debt

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

Under the loan covenants for the \$50 million revolving credit agreement, PJM is required to meet certain financial and non-financial covenants. PJM was in compliance with these covenants as of December 31, 2009.

At December 31, 2009, there were no outstanding borrowings under the revolving credit agreement. There was \$20 million in outstanding borrowings under the revolving credit agreement as of December 31, 2008. The interest rate on borrowings under this revolving credit agreement is based on NCSC's variable interest rate. This variable interest rate can change effective the first or 16th of any month. At December 31, 2009 and 2008, the interest rate was 6.05 percent and 5.00 percent, respectively.

## 7. Long-Term Project Debt

### *NCSC Project Development Facility*

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

Under the loan agreement for the \$110 million project development facility, PJM is required to meet certain financial and non-financial covenants. PJM was in compliance with these covenants as of December 31, 2009. As of December 31, 2009 and December 31, 2008, there were no outstanding borrowings under this facility. The interest rate on borrowings under this project development facility is based on NCSC's variable interest rate. The variable interest rate can change effective the first or 16th of any month. At December 31, 2009 and December 31, 2008, the interest rate was 6.05 percent.

### *PNC Bank Loan Agreement*

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

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

Under the loan agreement for the \$35 million loan, PJM is required to meet certain financial and non-financial covenants. PJM was in compliance with these covenants as of December 31, 2009.

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

<b>Year Ending December 31,</b>	
2010	\$ 2,333
2011	2,333
2012	2,333
2013	2,333
2014	2,333
Remaining	21,975
<b>Total</b>	<b>\$ 33,640</b>

#### ***Private Placement Loan Agreement***

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

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

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

<b>Year Ending December 31,</b>	
2010	\$ 5,770
2011	11,538
2012	11,538
2013	11,538
2014	11,538
Remaining	23,078
<b>Total</b>	<b>\$ 75,000</b>

## **8. Non-Recourse Debt**

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

This loan was paid in full on December 18, 2009. As of December 31, 2008, outstanding borrowings were \$1.1 million.

# Financial Report

## 9. Derivative Financial Instrument

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

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

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

<b>Year Ended December 31, 2009</b>	
Unrealized mark-to-market losses	\$ (131)
<b>Total net mark-to-market losses</b>	<b>\$ (131)</b>

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

## 10. Fair Value Disclosures

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

Under this guidance, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). In determining fair values, PJM utilizes market data or assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and the risks inherent in the inputs to the valuation technique. The authoritative guidance pertaining to fair value establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement). The three levels of the fair value hierarchy defined by this guidance are as follows:

**Level 1** – Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis.

**Level 2** – Pricing inputs are other than quoted prices in active markets included in Level 1, which are either directly or indirectly observable as of the reporting date. Level 2 includes those financial instruments that are valued using broker quotes in liquid markets and other observable pricing data. Level 2 also includes those financial instruments that are valued using internally developed methodologies that have been corroborated by observable market data through correlation or by other means. Significant assumptions are observable in the marketplace throughout the full term of the instrument, can be derived from observable data or are supported by observable levels at which transactions are executed in the marketplace.

**Level 3** – Pricing inputs include significant inputs that are generally less observable than those from objective sources.

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

PJM utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. PJM is able to classify fair value balances based on the observability of the inputs. In accordance with the authoritative guidance, financial assets and liabilities are classified in their entirety based on the lowest level of observability for an input that is significant to the fair value measurement. PJM's assessment of the significance of a particular input to the fair value measurement requires the exercise of judgment, and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels. At December 31, 2009, those financial assets and liabilities measured at fair value using level one inputs were deposits on hand, operating cash and short-term debt. PJM's interest rate swap agreement associated with the loan from PNC of \$35 million was accounted for at fair value on a recurring basis based on Level 2 inputs within the fair value hierarchy.

## 11. Income Taxes

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

Year Ended December 31,	2009	2008	2007
Federal income taxes:			
Current	\$ (7,121)	\$ (3,010)	\$ 5,936
Deferred	(1,669)	4,605	(3,798)
Valuation allowance	(13,894)	(384)	2,100
	\$ (22,684)	1,211	4,238
State income taxes:			
Current	383	(1,673)	1,250
Deferred	(3,190)	1,982	(708)
Valuation allowance	(1,473)	(296)	666
	(4,280)	13	1,208
<b>Income tax (benefit) expense</b>	<b>\$ (26,964)</b>	<b>\$ 1,224</b>	<b>\$ 5,446</b>

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

# Financial Report

The effects of temporary differences giving rise to deferred income tax assets at December 31, 2009 and 2008, consisted of the following:

	2009	2008
Deferred tax liabilities:		
Fixed assets	\$ (10,969)	\$ (10,934)
Deferred pension and postretirement costs	(4,482)	(9,412)
	(15,451)	(20,346)
Deferred tax assets:		
Pension	13,285	13,427
Postretirement healthcare	16,975	20,606
Deferred regulatory liability	5,562	5,856
Net operating loss carryforwards	4,620	2,801
Accrued expenses	4,802	2,677
	45,244	45,367
Net deferred income tax assets	29,793	25,021
Valuation allowance	(5,519)	(20,885)
<b>Deferred income taxes, net</b>	<b>\$ 24,274</b>	<b>\$ 4,136</b>

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

Year Ended December 31,	2009	2008	2007
Income tax at the Federal statutory rate	\$ (8,934)	\$ 638	\$ 2,103
Increase (decrease) resulting from:			
Change in valuation allowance	(14,395)	150	2,372
Meals and entertainment	154	175	173
State income taxes, net of Federal tax benefit	(2,824)	20	785
Other	(965)	241	13
<b>Income tax (benefit) expense</b>	<b>\$ (26,964)</b>	<b>\$ 1,224</b>	<b>\$ 5,446</b>

PJM has net operating loss carryforwards of \$69.4 million for Pennsylvania state tax purposes that begin expiring in 2021. PJM also had net operating losses for Federal income tax purposes that were carried back to prior periods.

Accounting for uncertainty in income taxes (ASC 740) requires the impact of a tax position be recognized if that position is more likely than not of being sustained upon examination by tax authorities based on the technical merits of the position. As of December 31, 2009, PJM has not recorded a (ASC 740) liability or receivable related to an uncertain income tax position.

As of January 1, 2008, in connection with adoption of FIN 48 (ASC 740), the Company identified and recorded an income tax liability related to uncertain tax positions of \$3.6 million that if reversed would have no impact on PJM's effective income tax rate. PJM also recorded a net interest liability of \$0.2 million and no penalties related to uncertain tax positions as of the date of adoption. The Company recognizes accrued interest, as well as any penalties related to recognized tax liabilities as a component of profit or loss before income taxes. During the third quarter of 2008, PJM filed the necessary forms with the Internal Revenue Service to change to the proper method of accounting related to the Company's FIN 48 (ASC 740) liability. At December 31, 2008, PJM no longer had a FIN 48 (ASC740) liability recorded or related interest.

PJM and its subsidiary file a U.S. consolidated Federal income tax return and separate company tax returns in the state of Pennsylvania. The statute of limitations has expired for tax years prior to 2005 for Federal purposes and state purposes. There are no ongoing audits at this time.

## 12. Benefit Plans

### Pension Plan

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

### Supplemental Executive Retirement Plan

PJM also sponsors a SERP to provide certain members of senior management with benefits in excess of normal pension benefits. At December 31, 2009 and 2008, the actuarially computed benefit obligation of the SERP included in the other employee benefits liability amounted to \$3.6 million and \$2.7 million, respectively. Pension expense for this plan was \$0.5 million, \$0.4 million and \$0.6 million for each of the years ended December 31, 2009, 2008 and 2007, respectively. Additionally, PJM recorded \$0.4 million in settlement expense in 2007 based on the level of distributions from the plan during the year. The SERP is not funded. However, PJM invested \$1.0 million in equity securities in January 2003 with the intention to use the proceeds to offset future obligations under the SERP. The investment is included in other non-current assets at its market value of \$1.0 million as of December 31, 2009.

### Postretirement Benefits

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

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

The schedules that follow show the changes in the benefit obligations, plan assets and funded status as of December 31, 2009 and 2008, and components of net periodic pension and postretirement healthcare costs of these plans for the years ended December 31, 2009, 2008 and 2007.

	Pension Benefits				Other Postretirement Benefits	
	Qualified		SERP		As of December 31,	
	As of December 31, 2009	2008	As of December 31, 2009	2008	2009	2008
<b>CHANGE IN BENEFIT OBLIGATION</b>						
Net benefit obligation at beginning of year	\$ 74,915	\$ 73,649	\$ 2,697	\$ 2,333	\$ 50,761	\$ 42,065
Service cost	4,428	4,339	175	176	3,880	4,234
Interest cost	4,653	4,381	188	173	2,855	2,933
Plan participants' contributions	–	–	–	–	105	111
Plan amendments	–	(986)	112	567	(10,732)	–
Actuarial (gain)/loss	6,425	(4,038)	481	(346)	(4,505)	2,039
Gross benefits paid	(4,727)	(2,430)	(73)	(206)	(547)	(621)
<b>Net obligation at end of year</b>	<b>\$ 85,694</b>	<b>\$ 74,915</b>	<b>\$ 3,580</b>	<b>\$ 2,697</b>	<b>\$ 41,817</b>	<b>\$ 50,761</b>

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

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	Pension Benefits				Other Postretirement Benefits	
	Qualified		SERP		As of December 31,	
	As of December 31, 2009	2008	As of December 31, 2009	2008	2009	2008
<b>CHANGE IN PLAN ASSETS</b>						
Fair value of plan assets at beginning of year	\$ 44,537	\$ 58,384	\$ -	\$ -	\$ -	\$ -
Actual return on plan assets	9,737	(16,484)	-	-	-	-
Employer contributions	7,000	5,067	73	206	442	510
Plan participants' contributions	-	-	-	-	105	111
Gross benefits paid	(4,727)	(2,430)	(73)	(206)	(547)	(621)
Fair value of plan assets at end of year	56,547	44,537	-	-	-	-
Funded status at end of year	(29,147)	(30,378)	(3,580)	(2,697)	(41,817)	(50,761)
Unrecognized net actuarial loss	-	-	-	-	-	-
Unrecognized prior service cost	-	-	-	-	-	-
Unrecognized net transition obligation	-	-	-	-	-	-
<b>Net amount recognized at end of year and amounts recognized in the statement of financial position</b>	<b>\$ (29,147)</b>	<b>\$ (30,378)</b>	<b>\$ (3,580)</b>	<b>\$ (2,697)</b>	<b>\$ (41,817)</b>	<b>\$ (50,761)</b>

	Pension Benefits				Other Postretirement Benefits	
	Qualified		SERP		As of December 31,	
	As of December 31, 2009	2008	As of December 31, 2009	2008	2009	2008
<b>AMOUNTS RECOGNIZED IN DEFERRED PENSION AND POSTRETIREMENT COSTS:</b>						
Net actuarial loss	\$ 21,801	\$ 23,198	\$ 455	\$ (26)	\$ (1,823)	\$ 2,682
Prior service cost	(292)	(339)	587	615	(9,687)	487
Transition obligation	-	-	-	4	-	228
<b>Total</b>	<b>\$ 21,509</b>	<b>\$ 22,859</b>	<b>\$ 1,042</b>	<b>\$ 593</b>	<b>\$ (11,510)</b>	<b>\$ 3,397</b>

	Pension Benefits				Other Postretirement Benefits	
	Qualified		SERP		As of December 31,	
	As of December 31, 2009	2008	As of December 31, 2009	2008	2009	2008
Amounts recognized in the statement of financial position consist of:						
Current liability	\$ -	\$ -	\$ (346)	\$ (52)	\$ (442)	\$ (1,024)
Noncurrent liability	(29,147)	(30,378)	(3,234)	(2,645)	(41,375)	(49,737)
Accrued benefit cost	-	-	-	-	-	-
Additional minimum liability	-	-	-	-	-	-
Intangible asset	-	-	-	-	-	-
<b>Net amount recognized at end of year</b>	<b>\$ (29,147)</b>	<b>\$ (30,378)</b>	<b>\$ (3,580)</b>	<b>\$ (2,697)</b>	<b>\$ (41,817)</b>	<b>\$ (50,761)</b>

At the end of 2009 and 2008, the projected benefit obligation, the accumulated benefit obligation and the fair value of plan assets for the qualified pension plan and SERP are as follows:

	Qualified		SERP	
	2009	2008	2009	2008
<b>End of Year</b>				
Projected benefit obligation	\$ 85,694	\$ 74,915	\$ 3,580	\$ 2,697
Accumulated benefit obligation	63,078	53,707	2,598	1,784
Fair value of plan assets	56,547	44,537	–	–

The accumulated benefit obligation of the other postretirement plan was \$41.8 million and \$50.8 million at December 31, 2009 and 2008, respectively. There were no plan assets for PJM's other postretirement benefit plan.

#### Expected Cash Flows

Information about expected cash flows for the pension and postretirement benefit plans follows:

	Qualified Benefits	SERP Benefits	Other Postretirement Benefits
<b>Employer Contributions</b>			
Expected employer contributions for 2010 to plan trusts	\$ 5,000	N/A	N/A
Expected employer contributions in form of direct benefit payments for 2010	–	\$ 347	\$ 1,062
<b>Expected Benefit Payments</b>			
2010	3,457	347	1,062
2011	3,715	76	1,280
2012	4,241	76	1,452
2013	4,992	75	1,636
2014	3,945	90	1,812
2015 - 2019	29,869	2,175	12,072

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

	Pension Benefits						Other Postretirement Benefits		
	Qualified			SERP			As of December 31,		
	As of December 31,	As of December 31,	As of December 31,	As of December 31,	As of December 31,	As of December 31,	As of December 31,	As of December 31,	
	2009	2008	2007	2009	2008	2007	2009	2008	2007
<b>COMPONENTS OF NET PERIODIC BENEFIT COST</b>									
Service cost	\$ 4,427	\$ 4,339	\$ 5,231	\$ 175	\$ 176	\$ 235	\$ 3,880	\$ 4,234	\$ 4,602
Interest cost	4,653	4,381	4,703	188	173	248	2,855	2,933	2,612
Expected return on assets	(3,291)	(4,290)	(4,117)	–	–	–	–	–	–
Amortization of:									
transition obligation (asset)	–	–	–	4	4	6	19	38	38
Prior service cost	(47)	(47)	112	140	50	(63)	(349)	39	39
Actuarial loss	1,376	–	583	–	–	130	–	–	178
Settlement	–	–	–	–	–	401	–	–	–
<b>Total net periodic benefit cost</b>	<b>\$ 7,118</b>	<b>\$ 4,383</b>	<b>\$ 6,512</b>	<b>\$ 507</b>	<b>\$ 403</b>	<b>\$ 957</b>	<b>\$ 6,405</b>	<b>\$ 7,244</b>	<b>\$ 7,469</b>

For the years ended December 31, 2009, 2008 and 2007, respectively, \$1.4 million, \$1.4 million and \$1.1 million of total pension and postretirement benefits expense were included in capitalized project costs.

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The following schedule shows the assumptions used to calculate the pension and postretirement benefit obligations as of December 31, 2009, 2008 and 2007.

	Pension Benefits			Postretirement Benefits		
	2009	2008	2007	2009	2008	2007
Discount rate	6.10%	6.10%	6.20%	6.30%	6.10%	6.20%
Expected return on plan assets	7.50%	7.75%	7.75%	N/A	N/A	N/A
Rate of compensation increase	4.50%	4.50%	5.00%	N/A	N/A	N/A
Medical care cost trend rate						
Current				9.25%	9.25%	10.00%
Ultimate				5.00%	5.00%	5.00%
Years to Ultimate				6	7	8

The effect of a 1.00 percent increase in the assumed healthcare cost trend rate from 9.25 percent to 10.25 percent would increase the postretirement benefit obligation as of December 31, 2009 by \$6.8 million and the current year postretirement benefit cost by approximately \$1.2 million. A 1.00 percent decrease in the assumed healthcare cost trend rate from 9.25 percent to 8.25 percent would decrease the accumulated postretirement benefit obligation by approximately \$5.4 million and would decrease the postretirement benefit cost by approximately \$0.9 million annually.

The asset allocation for PJM's pension plan at the end of 2009 and 2008, and the target allocation for 2010, by asset category, follows. The fair value of plan assets for this plan is \$56.6 million and \$44.5 million, at the end of 2009 and 2008, respectively. In addition, the expected long-term rate of return assumption on the plan assets was 7.50 percent in 2009 and 7.75 percent in 2008 and 2007.

Asset Category	Target Allocation	2009	2008
Equity securities	56% - 64%	59.9%	59.9%
Debt securities	37% - 41%	39.2%	39.2%
Other	0% - 2%	0.9%	0.9%
<b>Total</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

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

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

## Fair Value Measurements

The following table presents PJM's pension assets measured and recorded at fair value on PJM's Consolidated Statement of Financial Position on a recurring basis and their level within the fair value hierarchy as of December 31, 2009:

As of December 31, 2009 (a)	Level 1	Level 2	Level 3	Total
<b>Pension Plan Assets:</b>				
Cash Equivalents	\$ 438	\$ –	\$ –	\$ 438
Commingled Funds	–	47,692	–	47,692 (b)
Fixed Income	–	8,417	–	8,417 (c)
<b>Total Pension Plan Assets</b>	<b>\$ 438</b>	<b>\$ 56,109</b>	<b>\$ –</b>	<b>\$ 56,547</b>

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

(b) The benefit plans own commingled funds that invest in equity and fixed income securities. The commingled funds that invest in equity securities seek to out-perform the S&P 500 Index, the Russell 2500 Growth Index and Morgan Stanley Capital International Europe, Australasia and Far East Index. The commingled funds that hold fixed income securities seek to out-perform the Barclays Capital U.S. Aggregate Bond Index through investments in investment-grade fixed income securities and commingled funds.

(c) This category predominantly represents diverse issues of domestic, investment-grade fixed securities. This fund seeks to track the performance of the Barclays Capital U.S. Long Government/Credit Float Adjusted Bond Index.

## Valuation Techniques Used to Determine Fair Value

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

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

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

## Savings Plan

PJM also sponsors a 401(k) savings plan (the savings plan) for all eligible employees of the Company who have completed six months of service. The savings plan permits employees to contribute up to 15 percent of their gross compensation on a pretax basis, subject to limitations as described in the savings plan. PJM makes matching contributions equal to 100 percent of the employee's first 5 percent of gross salaries contributed. PJM contributions to the savings plan were approximately \$2.5 million, \$2.4 million and \$2.2 million for the years ended December 31, 2009, 2008 and 2007, respectively. This expense is included in compensation in the Consolidated Statement of Income, Comprehensive Income and Paid in Capital, Retained Earnings and Accumulated Other Comprehensive Income.

# Financial Report

## 13. Commitments and Contingencies

### Leases

PJM leases office space, furniture, computer and copier equipment under operating leases with various vendors. These leases are noncancelable and expire during the period from 2010 to 2013.

Future minimum rentals under noncancelable lease agreements are as follows:

Year Ending December 31,	
2010	\$ 2,540
2011	2,165
2012	1,875
2013	474
<b>Total</b>	<b>\$ 7,054</b>

### Regulatory Items

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

On May 21, 2007, ConEd filed a Petition for Rehearing of the FERC's April 20, 2007 Order. PSEG and ConEd filed appeals with the D.C. Circuit Court of Appeals on June 18, 2007, and June 19, 2007, respectively. On February 23, 2009, the parties to the complaint filed with the FERC a settlement offer to resolve all issues in this matter pending at the FERC and in the D.C. Circuit Court of Appeals. The settlement, if approved by the FERC, would provide "rolled over" service between ConEd and PSEG in accordance with transmission service agreements between PJM and ConEd and joint operating protocols between PJM and the NYISO. The filed settlement was contested. On February 19, 2010, the FERC found they were unable to approve the settlement because the current state of the record does not permit them to resolve the merits of some of the contested issues. Because these issues must be addressed before determining whether the settlement can be approved, the FERC will require the parties to brief these issues. The outcome of this matter is not anticipated to have any material adverse impact on PJM's financial position, results of operations or cash flow.

On May 30, 2008, 18 PJM Members, calling themselves the Reliability Pricing Model (RPM) Buyers filed with the FERC a complaint against PJM asking the FERC to find that PJM's RPM, as implemented through the "transitional" base residual auctions, has produced unjust and unreasonable capacity prices and to order refunds from the PJM members that received RPM revenues. PJM filed its answer on July 11, 2008, requesting that the FERC dismiss the complaint because the requested relief violates the filed rate doctrine, represents a collateral attack on the FERC's prior RPM orders and is contrary to the FERC's policy not to order the re-running of markets. The FERC dismissed the RPM Buyers' complaint on September 19, 2008. On October 20, 2008, the RPM Buyers filed a request for rehearing at FERC on this matter. On November 18, 2008, the FERC issued an order granting rehearing for further consideration for the limited purpose of giving itself additional time to consider the matters raised in the RPM Buyers' request for rehearing. Thereafter, the FERC issued an order on June 18, 2009 denying the RPM Buyers' request for rehearing, denying their request for oral argument, and reaffirming its September 19, 2008 order dismissing their complaint filed against PJM. On August 14, 2009, two of the 18 RPM Buyers, the Maryland Public Service Commission and New Jersey Board of Public Utilities, filed a Petition

for Review and Notice in the Fourth Circuit Court of Appeals to appeal the FERC's September 19, 2008 and June 18, 2009 orders. On November 12, 2009, an order was granted transferring the matter to the U.S. Court of Appeals for the District of Columbia Circuit Court. PJM cannot predict the outcome of this matter, but does not foresee any material adverse impact on PJM's operations or financial position.

On June 26, 2009, PJM reported to the FERC that it discovered a Market Flow modeling discrepancy, which affected the calculation of market-to-market coordination payments under the Joint Operating Agreement (JOA) between PJM and the Midwest Independent Transmission System Operator, Inc. (Midwest ISO). As a result of this discrepancy, the market-to-market coordination payments from PJM to the Midwest ISO have been significantly underpaid. The discrepancy has been rectified going forward, and PJM and Midwest ISO are working together to quantify the past underpayment. PJM and Midwest ISO were able to reach agreement on a methodology to calculate and quantify the impact of the error for the years 2007-2009, which resulted in an estimated error of approximately \$65 million for those two years. The RTOs, however, could not agree on a method to calculate the impact of the error for the years 2005-2007, how far back the recalculation should go or the application of the JOA's limitation of liability provisions. Furthermore, PJM is investigating potential errors by Midwest ISO in use of market-to-market coordination, which may offset any amounts owed to Midwest ISO by PJM. Thus, PJM and Midwest ISO initiated alternative dispute resolution under the JOA in September 2009. On September 15, 2009, this dispute was submitted to the FERC for dispute resolution by a settlement judge. The first settlement conferences were held on October 19 and October 20, 2009. Additional settlement conferences were held on December 10 and 11, 2009. The settlement proceedings continue and additional settlement conferences were held in February 2010. On March 8, 2010, the Midwest ISO filed two complaints against PJM with the FERC. The first complaint is seeking damages in the amount of \$130 million plus interest for the market flow modeling discrepancy for the period 2005 - June 2009. The second complaint alleges that PJM is in violation of the JOA because PJM allegedly demanded resettlement of amounts related to the Midwest ISO's use of substitute flowgates in the market-to-market processes under the JOA. The Midwest ISO has asked the FERC to order PJM to acknowledge the use of substitute flowgates under the JOA. The Midwest ISO is seeking reimbursement of \$5 million under the second complaint. A formal response on both matters is due March 29, 2010. PJM cannot predict the outcome of this matter, but does not foresee any material adverse impact on PJM's operations or financial position.

#### Other Items

At December 31, 2009, PJM had a receivable due from the Midwest ISO of \$33.4 million for Seams Elimination Cost Adjustments (SECA) billed for the eleven months ended March 31, 2006. While the Midwest ISO has billed Green Mountain Energy Trading (Green Mountain), the Midwest ISO customer responsible for the unpaid SECA charges, it has not yet received payment from that customer. The PJM transmission owners filed a motion on January 26, 2006, asking the FERC to use its civil enforcement powers to compel the defaulting Midwest ISO customer to comply with the Midwest ISO tariff and pay its allocated SECA charges. On September 26, 2008, PJM, the Midwest ISO and the RTOs' Transmission Owners filed a joint motion requesting the Commission to expeditiously act on the SECA matters pending before the Commission in the SECA proceeding as follows (i) approve the filed settlements; (ii) rule on two Initial Decisions issued by the presiding Administrative Law Judge; and (iii) grant the pending motions to enforce the orders, contracts and tariff requirements pursuant to which the Midwest ISO assessed against Green Mountain. This matter remains outstanding. The receivable from Midwest ISO is offset by the \$33.4 million payable by PJM to market participants for these SECA credits. Consequently, on a net basis, there are no amounts reported in the Consolidated Statement of Financial Position related to these items. Although PJM management cannot determine the impact, if any, of the final disposition of the amounts not yet collected by Midwest ISO from its market participants, the resolution will not have any impact on PJM's results of operations as PJM's Tariff only obligates PJM to disburse to its members the actual SECA charges collected.

On March 7, 2008, PJM filed a complaint with the FERC against Power Edge and its affiliates (collectively the Tower Affiliates) that transacted in the PJM markets alleging market manipulation, fraudulent distribution of Tower Affiliates' funds and fraudulent nonpayment of bills. In its complaint, PJM requested that the FERC order a public investigation, disgorgement of unjust revenues and profits of Power Edge and its affiliates, civil penalties and a bar on participation of Power Edge and its affiliates in PJM's markets. The Tower Affiliates filed an answer to PJM's complaint on March 27, 2008, and on April 30, 2008, the FERC issued an order holding the complaint in abeyance pending the completion of the FERC Office of Enforcement's investigation.

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On March 28, 2008, the Tower Affiliates filed a complaint against PJM at the FERC alleging that PJM was in violation of its Tariff by retaining collateral and revenues that they alleged should be paid to the Tower Affiliates. The Tower Affiliates requested that the FERC order PJM to remit to them \$11.0 million of collateral and \$14.7 million of net revenues plus interest. On April 17, 2008, PJM filed a response to the Tower Affiliates' complaint requesting that the FERC deny Tower Affiliates' request and allow PJM to retain the collateral and net revenues of Tower Affiliates until the FERC has completed its investigation into PJM's March 7, 2008 complaint and the civil complaint described below has been resolved. On April 2, 2009, the FERC issued an order directing PJM to return all collateral funds and trading revenues being held to the Tower Affiliates within 120 days. On April 15, 2009, PJM filed a request for clarification or rehearing in connection with this FERC order. Notwithstanding such request, pursuant to the FERC order, PJM returned \$37 million to Tower Affiliates on July 31, 2009, representing all collateral funds and trading revenues previously held. On August 21, 2009, the Tower Affiliates filed a protest at the FERC, seeking an additional \$1.6 million of interest. On October 2, 2009, the FERC issued an order, directing PJM to pay the Tower Affiliates additional interest in the amount of \$0.8 million. PJM paid such amount to the Tower Affiliates on October 19, 2009. The October 2, 2009 order additionally provided PJM its requested clarification that it is free to pursue its common law and civil actions in federal court.

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

On July 2, 2008, the Tower Affiliates filed a civil complaint against PJM in the Philadelphia County, Pennsylvania, Court of Common Pleas seeking return of the funds being withheld by PJM and compensatory and punitive damages for alleged interference with the Tower Affiliates' business relationships and defamation. PJM subsequently was able to remove the case to the United States District Court for the Eastern District of Pennsylvania (the Pennsylvania Case). On June 12, 2009, pursuant to an order of the U.S. District Court for the District of Delaware, the Delaware Case was transferred to the U.S. District Court for the Eastern District of Pennsylvania where, on July 13, 2009, it was consolidated with the Pennsylvania Case. PJM believes the Tower Affiliates' claims are without merit, and intends to vigorously defend against such claims.

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

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

## Legal

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

## 14. Related Party Transactions

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

In accordance with PJM's policies, PJM allows for cash advances to relocating employees. There were no advances outstanding at December 31, 2009 or 2008, respectively.



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