October 9, 2012

PJM Board of Managers:

Mr. Howard Schneider, Chair
Dr. Ake Almgren, Vice Chair
Mr. W. Terry Boston
Mr. John McNeely Foster
Dr. Jean D. Kinsey
Dr. Richard T. Lahey, Jr.
Mr. William R. Mayben
Ms. Susan J. Riley
Mr. Charles F. Robinson
Ms. Sarah Rogers

PJM Interconnection, LLC
955 Jefferson Avenue
Valley Forge Corporate Center
Norristown, PA  19403

Subject:  Finance Committee Recommendations

The Finance Committee met on August 22, 2012 and again on September 26, 2012 to review the proposed expense and capital budgets for 2013 as well as the proposed OPSI, NERC, RFC and Monitoring Analytics Budgets for 2013 and the Schedule 9-FERC rates for 2013.

In addition, the Committee reviewed PJM’s projected expenses and revenues for 2012 through 2016, including the estimated impact on rates and the deferred regulatory accounts. Additionally, a presentation and review of the proposed capital projects for 2013 was made at the August 23, 2012 Markets and Reliability Committee, the September 11, 2012 Operating Committee and the September 13, 2012 Planning Committee meetings.
1. **Proposed Expense Budget for 2013**

PJM has proposed an expense budget of $277 million for Stated Rate and the Advanced Control Center expenses in 2013. The PJM Sector-Elected Finance Committee members continue to applaud PJM Management for controlling the company’s expenses and providing timely, accurate and highly usable financial analysis for the committee. At first glance it may appear that expenses are rising inordinately, however, during the last several years PJM has been working to reach its full employee compliment. With that in mind, for 2007 – 2013(P) the CAGR (Compounded Average Growth Rate) is 6.0%. When looking at the inflation adjusted expenditure pattern back to 2007, the CAGR is 3.8% which is indicative of expectations for real expense while rising to full complement. This pattern of control is illustrated by the line graphs shown in the chart below:
Last year, PJM proposed, and the PJM Board of Managers ("Board") approved, an expense budget of $269 million for 2012. Current forecasts predict PJM’s actual expenses will be $266 million for 2012 which is lower than the approved budget for this year.

The Sector-Elected representatives of the PJM Finance Committee recommend that the Board approve this expense budget while encouraging PJM Management to continue to seek and sustain cost-saving initiatives that enhance efficiency, reliability, and the effectiveness of PJM markets.

2. Proposed 2013 Capital Budget

PJM has proposed a capital budget of $32 million for 2013. Year-over-year comparison to the 2012 budget shows an increase of $2 million or 6.6%. The majority of this increase is in the Applications & Systems Reliability area, which is completely offset by reductions in the Facilities & Technologies Infrastructure bucket. The areas then that drive the net increase are $1 million for NERC CIP & SSAE-16 compliance requirements and $1 million for the integration of East Kentucky Power Cooperative. The comparison is shown in the chart below:
(It should be noted that the projected 2012 capital spend is expected to be $25 million which is due to the advancing of $5 million of spending for the Conference and Training Center into 2011). The Sector-Elected representatives of the PJM Finance Committee recommend that the Board approve the proposed $32 million capital budget for 2013 and look forward to capital improvements being held to more modest increases in the future.

3. Proposed Schedule 9-FERC Rate for 2013

PJM has proposed a Schedule 9-FERC rate of $0.0595 per MWh of load for 2013. This proposed rate is based on an estimated $56 million of FERC’s electricity program costs being allocated to PJM and PJM’s projected transmission usage of 863 terawatt-hours for 2013. The 2012 9-FERC rate is $0.0689 per MWh; however, the FERC electricity program costs in 2011 and 2012 were almost the same, $165.5M and $165.2M respectively. The allocation to PJM is growing due to the integration of ATSI. The allocation for 2012 included a portion of ATSI and 2013 includes a full allocation for ATSI. Also, the Schedule 9-FERC rate includes an expected over-collection in 2012 of these funds from the PJM membership. The underlying rate for Schedule 9-FERC is unchanged from 2012 to 2013 because the cost of the FERC electricity program was essentially the same in 2011 and 2012. This was unexpected as the average annual increase from the previous four years was 10%. The issue of an unfair burden of FERC costs remains as in previous years.

The Sector-Elected representatives of the PJM Finance Committee recommend that the Board approve the proposed rate and request that PJM Management continue its pursuit of equity in charges levied to Regional Transmission Organizations (“RTOs”) by the FERC. This effort seems to have lost momentum in past years. The Sector-Elected representatives further request that the Board direct PJM Management to analyze and make an appropriate request
to the FERC on this matter so that future charges may be applied in a more reasonable manner. It is anticipated that this would take the form of appropriate PJM management working with stakeholders to make such a request.

5. Proposed Schedule 9-OPSI Rate for 2013

OPSI presented its approved budget of $626,075 for 2013, an increase of $18,235 over the 2012 budget of $607,840. Since this budget increase is below the 15% threshold requiring FERC review and approval, the Sector-Elected Representatives of the PJM Finance Committee accept OPSI’s budget for 2013. However, it should be noted that since its inception in 2007, OPSI’s annual budget has increased from $380,000 to $626,075 representing a CAGR of 8.7% as compared with a negative, -3.9%, CAGR for the same period based on the Consumer Price Index. Effectively, PJM has become a “Tax Collector” for OPSI and the Sector-Elected Representatives of the PJM Finance Committee urge the Board to direct PJM Management to discuss this situation with the President and Executive Director of OPSI to seek more modest increases in the future, in line with the economy and industry.
6. Proposed Schedule 9-MMU Rate for 2013

As shown in the above graph, the Monitoring Analytics budget has remained nearly flat since inception of 2009 and is projected to do so for 2013. There were no extraordinary issues of concern by the committee and the Sector-Elected Representatives of the PJM Finance Committee accept Monitoring Analytics budget for 2013.

7. Proposed Schedule 10 for NERC and RFC Budget

The NERC PJM expense budget for 2013 is proposed to decrease $0.7M mostly because of collection of penalties, however, the budget has a CAGR of 16.1% of the last 5 year interval, as compared with a negative, -10.4%, CAGR for the same period based on the Consumer Price Index. The Finance Committee has been told in the past that the annual increases were due to staffing increases to meet FERC requirements. However, the rate of this increase becomes suspect
when the RE (Regional Entity) is also increasing for the same reason. The rate of increase is illustrated in the chart below:

![Chart showing 2008-2013 PJM NERC Budget](chart.png)

For the PJM RFC budget, the story is similar, although it would appear more justified. They too have a need for more personnel and information technology infrastructure, however, the difference with the RE is that the RE is where the “rubber meets the road” and there is a more direct line of sight justifying the incremental needs. The CAGR associated with the 5 interval ending in 2013 is 11.6%, again, although high, more understandable than that associated with NERC. (Note: This CAGR is very high when compared with a negative, -10.4%, CAGR for the same period based on the Consumer Price Index).

It should be noted however, that part of the increase in cost for both the PJM NERC and RFC budgets is associated with an increase in the size of the PJM region, and as such in part, is justifiable.
However, the overall NERC and RFC budgets continue to climb at significant rates when compared to the same period for the consumer price index. The CAGR for the Total NERC budget for the last 5 year interval was 14.7% and for the Total RFC budget for the last 5 year interval was 12.4% respectively. Both well above the CPI CAGR of negative, -10.4%, for the same period.
The Sector-Elected Representatives of the PJM Finance Committee accept the NERC and RFC budgets with the **recommendation that the Board directs PJM Management to have discussion** with NERC and RFC pointing out the concern of the rate of increase in annual budgets vs. the benefits being derived.

8. **Comments**

PJM is expected to refund approximately $5 million in 2013 from the Deferred Liability Account. The current stated rate remains in effect. The quarterly refunds and stability of the current stated rate, year to year, provide great predictability to the membership. Unless for any reason the Deferred Liability Account becomes excessive in the future, the Sector-Elected representatives of the PJM Finance Committee recommend that PJM maintain the current course and hold the rate flat as long as possible.

The Finance Committee protocols continue to work well and foster collaborative efforts with PJM Management, the Board members, and the Sector-Elected
Finance Committee representatives. This includes both the organization of the annual Finance Committee plan, the materials and presentation of information, and the additional responses to supplemental requests and independent financial and PJM's annual SAS 70 Type 2 audits. The Finance Committee recommends continued focus on PJM Management's optimization of expenses and costs, consistent with the objective of PJM providing sound, reliable, efficient, and effective operations, while recognizing and adopting the potentially significant synergy impacts of new technology deployment on the overall costs and effectiveness of PJM.

The Sector-Elected representatives of the PJM Finance Committee are concerned about what appears to be ever increasing expenses with regard to the FERC, NERC and RFC. The representatives look forward to working with PJM management to find solutions to these growing issues for its membership.

We would appreciate the opportunity to meet with the Board, if required, to explain these recommendations in more detail and would appreciate feedback from the Board regarding the effectiveness of these recommendations after the approval of the proposed 2013 budget by the Board and stand ready to continue working with PJM Management to make the oversight by the Finance Committee as effective and constructive as feasible.

Sincerely,

Sector-Elected Representatives to the Finance Committee