PJM INTERCONNECTION, L.L.C.

FOR THE QUARTER ENDED JUNE 30, 2018

INDEX

PART I . FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

PJM INTERCONNECTION, L.L.C.
Consolidated Statement of Financial Position (Unaudited)

dollars in thousands	**June 30, 2018**		**December 31, 2017**	
Assets				
Current assets:				
Deposits on hand	$	1,702,041	$	1,458,744
Operating cash		386,686		308,321
Receivables		47,415		93,815
Study and interconnection receivables		15,899		7,065
Prepaid income taxes		14,381		17,968
Deferred FERC fees		1,115		2,229
Prepaid expenses and other		9,219		11,337
Note receivable		1,847		2,158
		2,178,603		1,901,637
Non-current assets:				
Fixed assets, net of accumulated depreciation and amortization of $653,422 and $630,398		105,380		113,111
Land		1,420		1,420
Projects in development		25,475		22,710
Deferred recovery of pension and postretirement costs		38,755		38,617
Deferred income taxes, net of valuation allowance		24,829		22,646
Note receivable		454		1,025
Other		23,950		23,172
		220,263		222,701
Total assets	$	2,398,866	$	2,124,338
Liabilities, paid-in capital, retained earnings				
and accumulated other comprehensive income				
Current liabilities:				
Accounts payable and accrued expenses	$	55,197	$	29,197
Due to members		445,414		397,396
Study and interconnection payables		15,734		7,134
Accrued payroll and benefits		15,908		30,506
Current portion of long-term debt		1,317		1,317
Current portion of capital lease		1,669		1,631
Deferred regulatory liability		2,415		132
Deferred revenue		1,839		3,387
Postretirement health care benefits liability		1,319		1,241
Other employee benefits		318		164
Deposits		1,702,041		1,458,744
		2,243,171		1,930,849
Non-current liabilities:				
Long-term debt		18,771		19,429
Long-term capital lease		15,935		16,774
Deferred regulatory liability		17,843		9,777
Interest rate swap		116		540
Pension benefits liability		12,737		60,935
Postretirement health care benefits liability		51,890		49,746
Other employee benefits		29,219		27,698
		146,511		184,899
Total liabilities		2,389,682		2,115,748
Commitments and contingencies (Note 11)				
Paid-in capital		722		722
Retained earnings		7,546		7,197
Accumulated other comprehensive income		916		671
Total paid-in capital, retained earnings and accumulated other comprehensive income		9,184		8,590
Total liabilities, paid-in capital, retained earnings and accumulated other comprehensive income	$	2,398,866	$	2,124,338

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

PJM INTERCONNECTION, L.L.C.
Consolidated Statement of Income, Comprehensive Income and Paid-in Capital, Retained Earnings and Accumulated Other Comprehensive Income (Unaudited)

	Three months ended June 30,		Six months ended June 30,	
dollars in thousands	**2018**	**2017**	**2018**	**2017**
Income				
Operating revenue				
Service fees	$ 72,727	$ 73,828	$ 150,870	$ 151,989
Deferred regulatory income	(2,335)	(3,417)	(10,349)	(12,306)
FERC fees reimbursement	14,971	14,479	31,088	29,821
Study and interconnection fees	1,022	1,062	2,013	1,994
Membership fees	924	867	1,814	1,716
Other	1,536	643	2,842	1,194
Total operating revenue	88,845	87,462	178,278	174,408
Operating expenses				
Compensation	33,801	32,185	68,869	66,718
FERC fees	14,971	14,479	31,088	29,821
Outside services	14,097	15,065	27,456	28,226
Depreciation and amortization	11,584	11,069	23,399	22,682
Software licenses and fees	4,591	4,406	8,291	8,268
Other expenses	4,356	3,775	7,252	5,173
Pension benefits	1,937	2,195	4,062	4,414
Computer maintenance and office supplies	1,170	1,577	3,837	3,958
Study and interconnection services	1,022	1,062	2,013	1,994
Lease expenses	477	522	938	1,098
Postretirement health care benefits	409	345	786	714
Total operating expenses	88,415	86,680	177,991	173,066
Operating income	430	782	287	1,342
Other income (expense)				
Interest income	2,859	1,230	5,113	2,257
Interest expense	2,622	1,408	4,619	2,414
Total other income (expense)	237	(178)	494	(157)
Income before income taxes	667	604	781	1,185
Income tax expense	282	467	432	930
Net income	$ 385	$ 137	$ 349	$ 255
Paid-in capital, retained earnings and accumulated other comprehensive income				
Beginning balance	8,791	8,241	8,590	8,098
Net income	385	137	349	255
Other comprehensive income	8	44	245	69
Ending balance	$ 9,184	$ 8,422	$ 9,184	$ 8,422

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

PJM INTERCONNECTION, L.L.C.
Consolidated Statement of Cash Flows (Unaudited)

	Six months ended June 30,			
dollars in thousands	**2018**		**2017**	
Cash flows from operating activities:				
Net income	$	349	$	255
Adjustments:				
Depreciation and amortization expense		23,399		22,682
Deferred income taxes, net of valuation allowance		(2,183)		(2,577)
Deferred recovery of pension and postretirement costs		(138)		(174)
Deferred regulatory liability		10,349		12,306
Employee benefit expense (less than) funding		(44,301)		(191)
Net fair value changes related to interest rate swap		(424)		(132)
Changes in assets and liabilities:				
Decrease in receivables		46,400		1,236
Increase in study and interconnection receivables		(8,834)		(7,126)
Decrease (increase) in prepaid expenses and other		784		(4,459)
Decrease in deferred FERC fees		1,114		1,037
Decrease (increase) in prepaid income taxes		3,587		(1,609)
Increase in accounts payable and accrued expenses		25,667		24,676
Increase in study and interconnection payables		8,600		7,022
Decrease in accrued payroll and benefits		(14,598)		(10,264)
Decrease in deferred revenue		(1,548)		(1,496)
Refunds to members		-		(3,855)
Net cash provided by operating activities		48,223		37,331
Cash flows from investing activities:				
Cost of projects in development		(18,100)		(21,911)
Note receivable		882		1,411
Net cash (used in) investing activities		(17,218)		(20,500)
Cash flows from financing activities:				
Borrowings under line of credit		74,427		45,730
Repayments under line of credit		(74,427)		(45,730)
Repayments of long-term debt		(658)		(659)
Increase (decrease) in due to members		48,018		(130,316)
Increase (decrease) in deposits		243,297		(51,705)
Net cash provided by (used in) financing activities		290,657		(182,680)
Net increase (decrease) in cash and cash equivalents		321,662		(165,849)
Cash and cash equivalents balance (including customer deposits), beginning of period		1,767,065		1,894,375
Cash and cash equivalents balance (including customer deposits), end of period	$	2,088,727	$	1,728,526
Noncash activity:				
Projects in development additions included in ending accounts payable and accrued expenses	$	333	$	289

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

1. Summary of Critical Accounting Policies

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 interim financial data as of June 30, 2018 and for the three-month and six-month periods ended June 30, 2018 and June 30, 2017 are unaudited; however, in the opinion of the Company, the interim data includes those adjustments of a normal recurring nature necessary for a fair statement of the results of the interim periods.

These footnotes should be read in conjunction with the Company's 2017 consolidated financial statements and footnotes.

PJM has performed an evaluation of subsequent events through August 7, 2018, which is the date the financial statements were issued.

Net Presentation of Member Activity

The Company has determined that although PJM has flash title to pooled transactions through its wholly-owned subsidiary, PJM Settlement, Inc. (PJM Settlement), all activity for which PJM Settlement is the central counterparty should be recorded on a net basis. The Company's determination is based on the fact that: (1) the member company, not PJM Settlement, is the primary obligor in each transaction, (2) PJM Settlement earns a fixed amount per transaction and, (3) the member company has the credit risk, not PJM Settlement. As such, the Company presents member activity for which PJM Settlement is the central counterparty, including accounts receivable, accounts payable, financial transmission rights (FTRs), revenue and expense, on a net basis in its consolidated financial statements.

2. Deferred Regulatory Liability

PJM recovers as service fees its administrative costs through a stated rate mechanism under the Company's Open Access Transmission Tariff (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 6 percent of its annual stated rates revenues, except that beginning for 2020 and every third year thereafter, the financial reserve must be reduced to 2 percent of annual stated rate revenues. The amount accumulated under the financial reserve provision is classified as a non-current liability in the Company's Consolidated Statement of Financial Position. On a quarterly basis, PJM refunds the deferred regulatory liability balance in excess of the permitted financial reserve for the previous quarter. 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. There were no refunds made during the first six months of 2018. During the first six months of 2017, PJM made refunds of $3.8 million.

Any under or over refund amounts will be reflected in the deferred regulatory liability activity in the following quarter.

For PJM Settlement, the deferred regulatory liability is defined in its rate schedule in the Tariff and is equal to revenues collected in excess of accrual-basis expenses. This balance is refunded quarterly. 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. The PJM Settlement rate schedule does not include a financial reserve element.

PJM recognizes deferred regulatory income 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 service fee revenues pursuant to the rate schedules differ from applicable expenses in the reporting period. The amount by which cumulative revenues under the rate schedules exceed cumulative expenses and refunds is reported as a deferred regulatory liability in the Consolidated Statement of Financial Position. In circumstances in which revenues are less than expenses, PJM reduces the deferred regulatory liability with an offset to deferred regulatory income.

At June 30, 2018 and December 31, 2017, the deferred regulatory liability balance was $20.2 million and $9.9 million, respectively. At June 30, 2018, the current portion of the deferred regulatory liability was $2.4 million to be refunded to members by PJM and PJM Settlement during third quarter 2018. At December 31, 2017, the current portion of the deferred regulatory liability was $0.1 million, representing PJM Settlement's expected refunds to members during the subsequent quarter, respectively. The non-current portion of the deferred regulatory liability of $17.8 million and $9.8 million represent the amount of PJM's reserve at June 30, 2018 and December 31, 2017, respectively.

3. Note Receivable

On March 21, 2008, the FERC approved a 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 the Board of Managers. 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 with MA during March 2008. The original loan agreement was extended in March 2014 to March 31, 2020.

The purpose of the PJM loan to MA is to fund capital needs associated with MA's 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 with MA has a capacity of $11 million. At June 30, 2018 and December 31, 2017, the interest rate on the loan agreement between PJM and MA was 5.00 and 4.50 percent, respectively. The interest rate on all loan advances is equal to the PNC Bank Base Rate. The PNC Bank Base Rate is the highest of (A) the Prime Rate, (B) the sum of the Federal Funds Rate plus 50 basis points (0.50 percent), or (C) the sum of the Daily London Interbank Offered Rate (LIBOR) plus 100 basis points (1.0 percent).

At June 30, 2018 and December 31, 2017, the outstanding balance due from MA recorded by PJM as a note receivable was $2.3 million and $3.2 million, respectively. At June 30, 2018 and December 31, 2017, the current portion of the note receivable was $1.8 million and $2.2 million, respectively. The current balance at June 30, 2018, represents the amount to be repaid in the next twelve months. The non-current portion of the note receivable was $0.5 million and $1.0 million at June 30, 2018 and December 31, 2017, respectively.

4. Short-Term Debt

PNC Revolving Line of Credit

On March 1, 2018 PJM amended and restated the existing revolving credit agreement with PNC Bank (PNC) increasing the capacity from $100 million to $150 million. PJM received approval from the FERC to continue to borrow under this amended facility and to increase the unsecured promissory note on January 19, 2018. The facility expires on January 31, 2020, and can be extended automatically through February 28, 2021, with FERC authorization. The revolving line of credit is unsecured and available to fund short-term cash obligations.

Under the loan covenants for the revolving credit agreement, PJM is required to meet certain financial and non-financial covenants. PJM was in compliance with these covenants as of June 30, 2018. At June 30, 2018 and December 31, 2017, there were no amounts outstanding under the revolving credit agreement. The interest rate on borrowings under this revolving credit agreement is based on the 30-day LIBOR. At June 30, 2018 and December 31, 2017, the interest rate was 2.715 percent and 2.314 percent, respectively.

The newly amended facility also has a commitment fee of 6.25 basis points on the unused balance. This fee is calculated daily and paid quarterly.

5. Long-Term Debt

PNC Bank Loan Agreement

On March 31, 2009, the FERC approved PJM's application to enter into a $35 million loan agreement with PNC. The loan had a seven-year term and is collateralized by the Advanced Control Center (AC^2) property. The closing on this facility occurred on April 30, 2009.

On August 22, 2013, the FERC approved PJM's application to amend and refinance at a lower interest rate the original loan with PNC, which had a balance of $26.3 million. The closing on this facility occurred on September 5, 2013. Under the amended loan, the maturity was extended from April 30, 2016 to September 1, 2021. Payments are due monthly.

On March 24, 2016, PJM and PNC amended the loan agreement to reduce the spread over LIBOR from 110 basis points to 75 basis points. The commitment amount of the loan and maturity date was not changed.

As of June 30, 2018 and December 31, 2017, outstanding borrowings under this loan were $20.1 million and $20.7 million, respectively. As defined in the loan agreement, the interest rate is based on the LIBOR in effect at each reset date plus a spread of 75 basis points. The reset date is monthly. As of June 30, 2018 and December 31, 2017, the interest rate was 2.732 percent and 2.111 percent, respectively.

Under the loan agreement, PJM was required to meet certain financial and non-financial covenants. PJM was in compliance with these covenants as of June 30, 2018.

On June 28, 2018, FERC approved PJM's request to refinance the bank loan currently with PNC with a new term loan from Bank of America. See additional refinancing discussion in Subsequent Event Note 12.

6. Derivative Financial Instrument – Interest Rate Swap

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 its variable rate debt using an interest rate swap, which is a derivative financial instrument.

To manage interest rate risk associated with the amended loan agreement of $26.3 million with PNC, the Company entered into an interest rate swap agreement with PNC on September 5, 2013. The interest rate swap agreement effectively fixed the interest payments on the Company's floating rate debt instrument at a rate of 2.85 percent plus the spread over LIBOR through September 1, 2021, which resulted in a fixed interest rate of 3.95 percent. The April 2016 amendment of the loan agreement together with the interest rate swap reduced the effective interest rate on the outstanding principal amount of the loan from 3.95 percent to 3.60 percent. 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 elected not 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 June 30, 2018 and December 31, 2017, the fair value of the swap was a liability of $0.1 million and $0.5 million, respectively.

The amount of the derivative gains PJM recognized as interest expense in the Consolidated Statement of Income, Comprehensive Income and Paid-in Capital, Retained Earnings and Accumulated Other Comprehensive Income is provided in the table below:

	Three months ended	
	June 30, 2018	**June 30, 2017**
Unrealized mark-to-market gains (losses)	$ 140	$ (11)
Total net mark-to-market gains (losses)	$ 140	$ (11)
	Six months ended	
	June 30, 2018	**June 30, 2017**
Unrealized mark-to-market gains	$ 424	$ 132
Total net mark-to-market gains	$ 424	$ 132

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

In connection with the refinancing of PJM's long-term debt, this interest rate swap with PNC was terminated on July 19, 2018, and a new interest rate swap was executed with Bank of America. See additional refinancing discussion in Subsequent Event Note 12.

7. Derivative Financial Instrument – FTRs

PJM Settlement is the central counterparty to member's pool transactions. Accordingly, PJM Settlement has flash title pass through it when markets settle and as charges / credits are assessed on pool transactions.

An FTR is a financial instrument that enables market participants to reduce their congestion-related price risk when delivering or selling energy on the grid. It provides an economic hedging mechanism against congestion charges that can be transacted by members separately from transmission service. Ultimately, PJM Settlement is neither the buyer nor seller of FTRs but, as FTR auctions clear, PJM Settlement believes it is temporarily the counterparty to both the FTR Buyer and the FTR Seller. For reporting purposes, these positions net to zero in the Consolidated Statement of Financial Position and the Consolidated Statement of Income, Comprehensive Income and Paid-in Capital, Retained Earnings and Accumulated Other Comprehensive Income and do not represent a credit risk to PJM. However, because FTRs have ongoing open positions at period end, the Company is disclosing the fair value of these instruments.

The gross fair value of both the FTR assets and FTR liabilities as of June 30, 2018, was $618 million. A total of 254 members were FTR holders related to a total of 2,157,421 megawatt hours. As of June 30, 2018, PJM held $1,480 million in collateral related to these FTR transactions. The collateral is based on the calculated net value of the positions held in each member's FTR portfolio. The collateral can be in the form of cash or a letter of credit.

Roll-forward of FTR activity for the quarter ended June 30, 2018:

dollars in millions

Balance at April 1, 2018	$ 171
Auction additions	758
Settlement and change in fair value	(311)
Balance at June 30, 2018	$ 618

8. Fair Value Disclosures

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 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.

The following table presents PJM's cash and cash equivalents as well as financial liabilities that were accounted for at fair value on a recurring basis as of June 30, 2018 and December 31, 2017 by level within the fair value hierarchy.

dollars in millions

	June 30, 2018				December 31, 2017
	Level 1	**Level 2**	**Level 3**	**Carrying Value**	**Carrying Value**
Cash and cash equivalents	$ 2,088	$ -	$ -	$ 2,088	$ 1,767
Deposit liabilities	1,702	-	-	1,702	1,458
Derivative liabilities	-	1	-	1	1

The fair value of FTR assets and liabilities for which PJM Settlement is the counterparty for an instant are determined on a recurring basis based on Level 3 inputs within the fair value hierarchy. The valuation model used is based on a three year weighted average of historical Location Marginal Prices by month by node. The model also calculates separate historic values for on-peak, off-peak and 24-hour FTRs. For reporting purposes, these positions net to zero in the Consolidated Statement of Financial Position and the Consolidated Statement of Income, Comprehensive Income and Paid-in Capital, Retained Earnings and Accumulated Other Comprehensive and are not presented in the table above.

9. Benefit Plans

	Pension Benefits				Other Postretirement Benefits	
Components of Net Periodic Benefit Cost	**Qualified**		**SERP***			
for the period April 1 to June 30	**2018**	**2017**	**2018**	**2017**	**2018**	**2017**
Service cost	$ 2,696	$ 2,383	$ 92	$ 61	$ 421	$ 386
Interest cost	2,250	2,158	68	52	573	604
Expected return on assets	(3,718)	(2,665)	-	-	(167)	(116)
Prior service cost / (gain)	(5)	(5)	2	2	(322)	(322)
Actuarial loss / (gain)	542	294	91	33	(14)	(89)
Total net periodic benefit cost	$ 1,765	$ 2,165	$ 253	$ 148	$ 491	$ 463

**Supplemental Executive Retirement Plan*

For each of the three month periods ended June 30, 2018 and June 30, 2017, $0.1 million and $0.2 million of total pension and postretirement benefits expense were included in capitalized project costs, respectively.

	Pension Benefits				Other Postretirement Benefits	
Components of Net Periodic Benefit Cost	**Qualified**		**SERP***			
for the period January 1 to June 30	**2018**	**2017**	**2018**	**2017**	**2018**	**2017**
Service cost	$ 5,565	$ 4,767	$ 180	$ 122	$ 853	$ 773
Interest cost	4,514	4,317	134	104	1,133	1,207
Expected return on assets	(7,444)	(5,329)	-	-	(334)	(232)
Prior service cost / (gain)	(9)	(10)	3	3	(643)	(644)
Actuarial loss / (gain)	1,121	587	166	66	(55)	(178)
Total net periodic benefit cost	$ 3,747	$ 4,332	$ 483	$ 295	$ 954	$ 926

For each of the six month periods ended June 30, 2018 and June 30, 2017, $0.3 million and $0.4 million of total pension and postretirement benefits expense were included in capitalized project costs, respectively.

During first quarter of 2018, PJM contributed $50.0 million to its qualified defined benefit pension plan. This contribution resulted in the reduction of the Company's pension liability to $12.7 million at June 30, 2018.

Assumptions used to determine net periodic benefit cost as of June 30	**Pension Benefits**			**Postretirement**			
	2018	**2017**		**2018**	**2017**		
Discount rate	3.70%	4.40%		3.70%	4.40%		
Expected return on plan assets	6.60%	6.75%		6.60%	6.75%		
Rate of compensation increase	4.50%	4.50%		N/A	N/A		
Medical care cost trend rate							
Current (Pre-65)				6.93%	6.42%		
Current (Post-65)				6.17%	7.37%		
Ultimate (Pre-65)				4.45%	4.46%		
Ultimate (Post-65)				4.46%	4.45%		
Years to ultimate				20	21		

10. Income Taxes

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

	Six months ended June 30,		
	2018	**2017**	
Income tax expense at the federal statutory rate	$ 179	$ 415	
Increase (decrease) resulting from:			
Change in valuation allowance	(8)	173	
Permanent items	125	202	
State income taxes, net of federal tax benefit	136	119	
Other	-	21	
Income tax expense	$ 432	$ 930	

PJM and its subsidiaries file a U.S. consolidated federal income tax return and separate company tax returns in the state of Pennsylvania (PA). The statute of limitations has expired for tax years prior to 2014 for Federal purposes and state purposes. There are no ongoing income tax audits at this time.

11. Commitment and Contingencies

Other Items

Marginal Line Loss Surplus Payment Reallocation

Between July 17, 2012, and July 20, 2012, fourteen companies defaulted on payment obligations totaling $28 million, net of collateral held by PJM. These obligations resulted from reallocations for previously ordered, and provided, refunds made to certain market participants for billing adjustments related to the marginal line loss payment surplus allocation methodology under PJM's Operating Agreement and Tariff, which was ordered by the FERC at Docket No. EL08-14 on July 21, 2011. PJM Settlement considered all alternatives to enforce its contract rights from all non-paying companies, and to this end, filed two complaints in civil action alleging breach of contract in the state of Delaware against former members. The first complaint, filed on November 7, 2012, naming City Power Marketing, LLC, Energy Endeavors, LLC, Energy Endeavors, LP and Crane Energy, LP, seeks the recovery of approximately $23 million owed to PJM Settlement, while the second complaint, filed on December 6, 2012, naming Round Rock Energy, LLC, Round Rock Energy, LP, Huntrise Energy Fund, LLC and certain named principals individually, seeks the recovery of approximately $4 million.

Several parties affected by the FERC's underlying ruling in this matter sought judicial review of the FERC's decision in the United States Court of Appeals for the District of Columbia Circuit and, in the ruling issued in August 2013, the court of appeals directed FERC to provide additional support for its determination to recoup the previously ordered refunds. On February 20, 2014, FERC issued an order establishing a schedule for parties to brief the issue of whether it should have ordered recoupment of the refunds. Initial briefs were submitted by several parties, including PJM, on April 7, 2014. Reply briefs were submitted by PJM and several parties on May 6-7, 2014. On November 19, 2015, the FERC issued an order affirming its decision ordering recoupment of refunds. On April 7, 2016, the FERC issued an order denying a rehearing request. On June 6, 2016, Energy Endeavors, L.P. filed a petition for review of the recoupment order in the United States Court of Appeals for the District of Columbia Circuit. On or about November 7, 2016, FERC filed an unopposed motion and requested the court of appeals to remand the recoupment order. Energy Endeavors, L.P. did not oppose the motion. Accordingly, the court granted FERC's motion and remanded the recoupment order on November 9, 2016 to FERC. The recoupment order is thus before FERC for additional proceedings and, at present, is not final.

The collection actions referenced above remain stayed in the Delaware courts. Under the terms of the PJM Operating Agreement, any payment defaults may be billed and collected from PJM Settlement'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.

TranSource Matter

On June 23, 2015, TranSource, LLC (TranSource) filed a complaint (Complaint) against PJM with the FERC. In the Complaint, TranSource asked the FERC to order PJM to provide work papers used to determine the cost estimates for each individual system upgrade specified in System Impact Studies and to suspend all Tariff deadlines otherwise applicable to its Incremental Auction Revenue Rights (IARR) request, pending receipt of the demanded information. On September 24, 2015, the FERC issued an order (the September 24 Order) setting the Complaint for a trial-type evidentiary hearing. The FERC encouraged the parties to settle their disputes, held the hearing in abeyance and directed appointment of a settlement judge. As directed by the FERC, PJM, TranSource and the affected PJM transmission owners (which had intervened in the case), engaged in settlement discussions with the assistance of the assigned settlement judge. On February 10, 2016, while in settlement discussions, TranSource filed an amendment to the Complaint (the Amended Complaint). In the Amended Complaint, TranSource claims it incurred $72 million in lost profit opportunities from monthly IARRs during calendar year 2015. On February 25, 2016, the settlement judge declared an impasse and is expected to issue a report appointing a hearing judge. PJM believes the claim for monetary damages in the Amended Complaint is speculative and without merit because TranSource cannot show that PJM failed to meet any obligation owed to TranSource or that such alleged failure provides any basis to award TranSource monetary relief. Furthermore, as a signatory to the System Impact Study Agreement, TranSource expressly agreed that they are not entitled to consequential damages or lost profits from any asserted delay or non-performance by PJM or the associated transmission owner. PJM sought to dismiss the Amended Complaint with prejudice on procedural and substantive grounds. On March 22, 2016, the Chief Judge granted the motion filed by PJM and the PJM Transmission Owners to hold the proceeding in abeyance pending the Commission's decision on PJM's request for dismissal of the Amended Complaint.

On August 30, 2017, TranSource submitted a motion accepted by the Presiding Judge permitting a TranSource witness to testify at hearing held in September 2017 regarding additional evaluations conducted based on the late presentation of the documents by one of the Interconnected Transmission Owners. Parties' initial post-hearing briefs were filed on October 2017 with reply briefs filed in November 2017. On January 19, 2018, the Administrative Law Judge assigned issued an initial decision finding that PJM's practices used to process TranSource's Upgrade Requests during the System Impact Study phase were nontransparent; and the impact of the system impact study phase, as applicable to TranSource was discriminatory under the Federal Power Act and therefore unjust and unreasonable. TranSource was granted limited relief, ordering PJM to restore TranSource's original queue position and refund the $0.15 million paid by TranSource for the study of its upgrade request. All other requests for relief were denied. PJM filed a brief on exceptions on February 20, 2018. A final decision will be issued by the Commission after considering all exception briefs filed. PJM does not believe that this matter will have a material adverse effect on its financial position, results of operations or cash flow.

Credit Matter

On June 22, 2018, PJM members were notified that GreenHat Energy, LLC defaulted on its obligations related to its FTR portfolio, which includes position applicable to the current planning year as well as the subsequent two planning years. The aggregate payment default of this member, net of collateral held, will be billed to the non-defaulting members in accordance with the default allocation assessment formula in the PJM Operating Agreement. The outcome of the default is not anticipated to have an 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.

12. Subsequent Event

Bank of America (BoA) Bank Loan Agreement

On June 28, 2018, FERC approved PJM's request to refinance the bank loan with PNC through a new term loan from BoA. On July 20, 2018, PJM entered into a $20.2 million loan agreement with BoA. The loan has a 7-year term and is unsecured. As defined in the loan agreement, the term loan shall bear interest at a rate per annum equal to the LIBOR rate plus a spread of 65 basis points (0.65 percent). As of the closing date of the loan, the interest rate was 2.74 percent.

To manage interest rate risk associated with the $20.2 million loan agreement with BoA, the Company entered into an interest rate swap agreement with BoA effective August 1, 2018. The interest rate swap agreement effectively fixes the interest payments of the Company's floating rate debt instrument at a rate of 3.62 percent. The term of the interest rate swap matches the term of the loan.

In conjunction with the establishment of the term loan and related interest rate swap with BoA, on July 19, 2018 PJM terminated the existing bank loan and interest rate swap with PNC. PJM made a payment of $20.1 million to PNC in order to extinguish the PNC term loan and terminate the interest rate swap. For accounting purposes, this transaction will be recorded in third quarter 2018 as an extinguishment of debt.

PART I. FINANCIAL INFORMATION (continued)

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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, 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 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 Interconnection, L.L.C.'s (PJM or the Company) 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.

Results of Operations

Revenues and Expenses

PJM's service fees decreased $1.1 million, or 1 percent, to $72.7 million for the three months ended June 30, 2018 compared with the three months ended June 30, 2017; and decreased $1.1 million or 1 percent, to $150.8 million for the six months ended June 30, 2018 compared with the six months ended June 30, 2017. Transmission volume for the three and six month periods ended June 30, 2018 were 196 terawatt hours (TWhs) and 406 TWhs as compared with 191 TWhs and 393 TWhs for the three and six month periods ended June 30, 2017.

Total expenses, excluding FERC fees, study and interconnection services, interest expense and income taxes, increased $1.3 million, or 2 percent, to $72.4 million for the three month period June 30, 2018 as compared with the three month period ended June 30, 2017; and $3.6 million, to $144.9 million for the six months ended June 30, 2018 as compared with the six months ended June 30, 2017. For the six month period ended June 30, 2018, the increases in compensation expense and computer maintenance and office supplies are due to normal cost of living adjustments and the timing of computer hardware purchases.

Liquidity and Capital Resources

PJM has a revolving credit agreement with PNC Bank (PNC) for $150 million, which expires on January 31, 2020, and can be extended automatically through February 28, 2021. At June 30, 2018, there were no outstanding borrowings under the revolving credit agreement.

On March 31, 2009, FERC approved PJM's application to enter into a $35 million loan agreement with PNC. On August 22, 2013, FERC approved PJM's application to amend and refinance at a lower interest rate the original loan with PNC for $26.3 million. The closing of this facility occurred on September 5, 2013. Under the amended loan, the maturity was extended from April 30, 2015 to September 1, 2021. At June 30, 2018 the outstanding borrowings under the amended loan were $20.1 million.

On June 28, 2018, FERC approved PJM's request to refinance the bank loan with PNC through a new term loan from Bank of America (BoA). On July 20, 2018, PJM entered into a $20.2 million loan agreement with BoA. The loan has a 7-year term and is unsecured. As defined in the loan agreement, the term loan shall bear interest at a rate per annum equal to the LIBOR rate plus a spread of 65 basis points (0.65 percent). As of the closing date of the loan, the interest rate was 2.74 percent.

To manage interest rate risk associated with the $20.2 million loan agreement with BoA, the Company entered into an interest rate swap agreement with BoA effective August 1, 2018. The interest rate swap agreement effectively fixes the interest payments of the Company's floating rate debt instrument at a rate of 3.62 percent. The term of the interest rate swap matches the term of the loan.

In conjunction with the establishment of the term loan and related interest rate swap with BoA, on July 19, 2018 PJM terminated the existing bank loan and interest rate swap with PNC. PJM made a payment of $20.1 million to PNC in order to extinguish the PNC term loan and terminate the interest rate swap. For accounting purposes, this transaction will be recorded in third quarter 2018 as an extinguishment of debt.

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:

Credit Risks

PJM bills its service fees to its members monthly under the stated rate tariff. For the six month period ended June 30, 2018, approximately sixty percent of PJM's service fees were billed to twenty nine of its members, each of which have an investment-grade credit rating according to at least one of three major rating services or have provided a guaranty from an affiliate with an investment-grade rating. In the event of default by any PJM member(s), the remaining PJM members would be billed a ratable portion of the default.

In accordance with PJM's credit policy, PJM obtains collateral from its members 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.

Recent Regulatory Actions

Marginal Line Loss Surplus Payment Reallocation

Between July 17, 2012, and July 20, 2012, fourteen companies defaulted on payment obligations totaling $28 million, net of collateral held by PJM. These obligations resulted from reallocations for previously ordered, and provided, refunds made to certain market participants for billing adjustments related to the marginal line loss payment surplus allocation methodology under PJM's Operating Agreement and Tariff, which was ordered by the FERC at Docket No. EL08-14 on July 21, 2011. PJM Settlement considered all alternatives to enforce its contract rights from all non-paying companies, and to this end, filed two complaints in civil action alleging breach of contract in the state of Delaware against former members. The first complaint, filed on November 7, 2012, naming City Power Marketing, LLC, Energy Endeavors, LLC, Energy Endeavors, LP and Crane Energy, LP, seeks the recovery of approximately $23 million owed to PJM Settlement, while the second complaint, filed on December 6, 2012, naming Round Rock Energy, LLC, Round Rock Energy, LP, Huntrise Energy Fund, LLC and certain named principals individually, seeks the recovery of approximately $4 million.

Several parties affected by the FERC's underlying ruling in this matter sought judicial review of the FERC's decision in the United States Court of Appeals for the District of Columbia Circuit and, in the ruling issued in August 2013, the court of appeals directed FERC to provide additional support for its determination to recoup the previously ordered refunds. On February 20, 2014, FERC issued an order establishing a schedule for parties to brief the issue of whether it should have ordered recoupment of the refunds. Initial briefs were submitted by several parties, including PJM, on April 7, 2014. Reply briefs were submitted by PJM and several parties on May 6-7, 2014. On November 19, 2015, the FERC issued an order affirming its decision ordering recoupment of refunds. On April 7, 2016, the FERC issued an order denying a rehearing request. On June 6, 2016, Energy Endeavors, L.P. filed a petition for review of the recoupment order in the United States Court of Appeals for the District of Columbia Circuit. On or about November 7, 2016, FERC filed an unopposed motion and requested the court of appeals to remand the recoupment order. Energy Endeavors, L.P. did not oppose the motion. Accordingly, the court granted FERC's motion and remanded the recoupment order on November 9, 2016 to FERC. The recoupment order is thus before FERC for additional proceedings and, at present, is not final.

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