

September 25, 2013

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

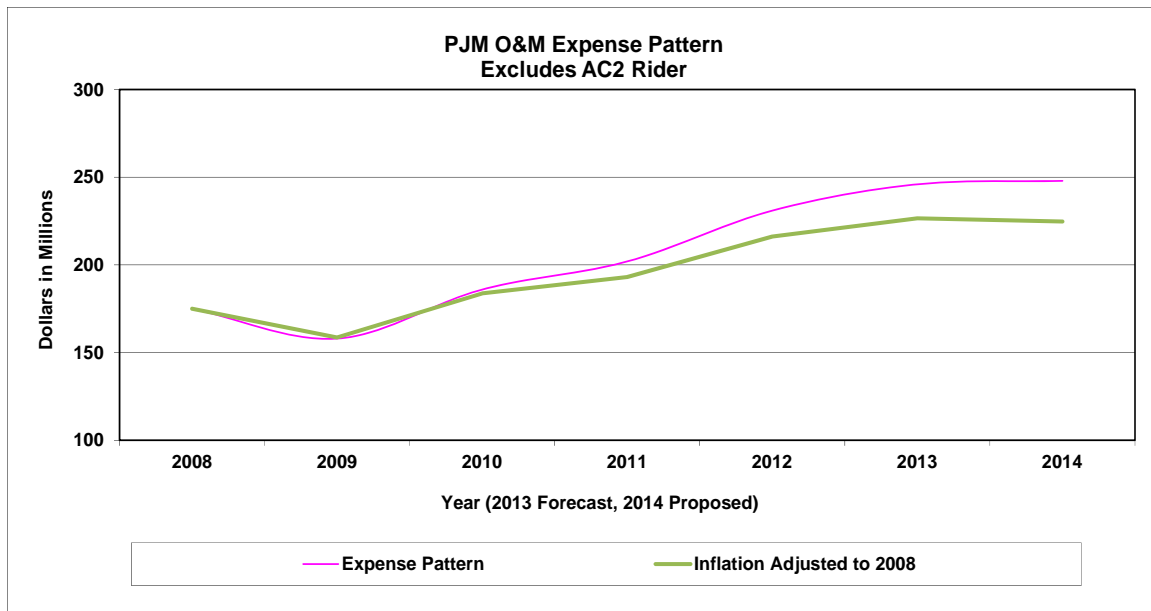
Subject: Finance Committee Recommendations

The Finance Committee met on August 20, 2013 and again on September 17, 2013 to review the proposed expense and capital budgets for 2014 as well as the proposed OPSI, NERC, RFC and Monitoring Analytics Budgets for 2014 and the Schedule 9-FERC rates for 2014.

In addition, the Committee reviewed PJM's projected expenses and revenues for 2013 through 2017, including the estimated impact on rates and the deferred regulatory accounts. Additionally, a presentation and review of the proposed capital projects for 2014 was made at the September 10, 2013 Operating Committee, the September 12, 2013 Planning Committee and September 23, 2013 Members Committee meetings.

1. Proposed Expense Budget for 2014

PJM has proposed an expense budget of \$276 million for Stated Rate and the Advanced Control Center expenses in 2014. The PJM Sector-Elected Finance Committee members appreciate PJM Management for continuing to control the company's expenses, most notably through pension changes for 2014, and providing timely, accurate and highly usable financial analysis for the committee. It may appear that expenses are rising greater than expected, however, during the last several years PJM has been working to reach its full employee complement. With that in mind, (excluding the AC2 Rider), for 2008 – 2014(P), the CAGR (Compounded Average Growth Rate) is 6.0%. When looking at the inflation adjusted expenditure pattern back to 2008 however, the CAGR is only 4.3%, which is indicative of expectations for real expense while rising to full employee complement and maintaining operations at an expected/acceptable level. This pattern of control is illustrated by the line graphs shown in the chart below:

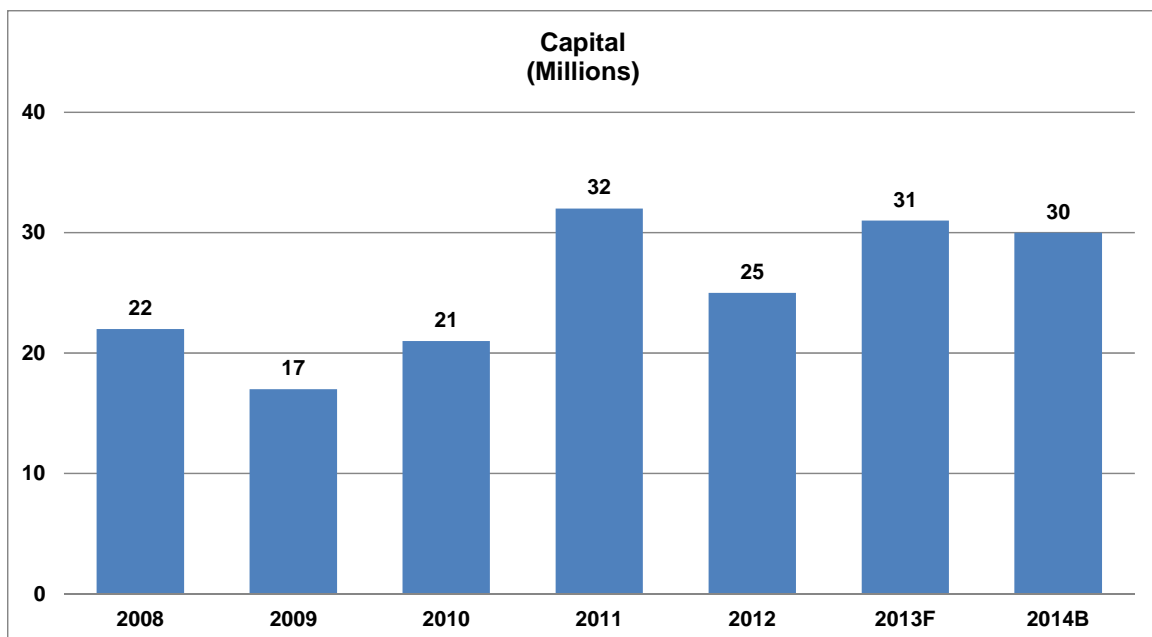


Last year, PJM proposed, and the PJM Board of Managers ("Board") approved, an expense budget of \$277 million for 2013. Current forecasts predict PJM's actual expenses will be \$276 million for 2013, which is lower than the approved budget for this year.

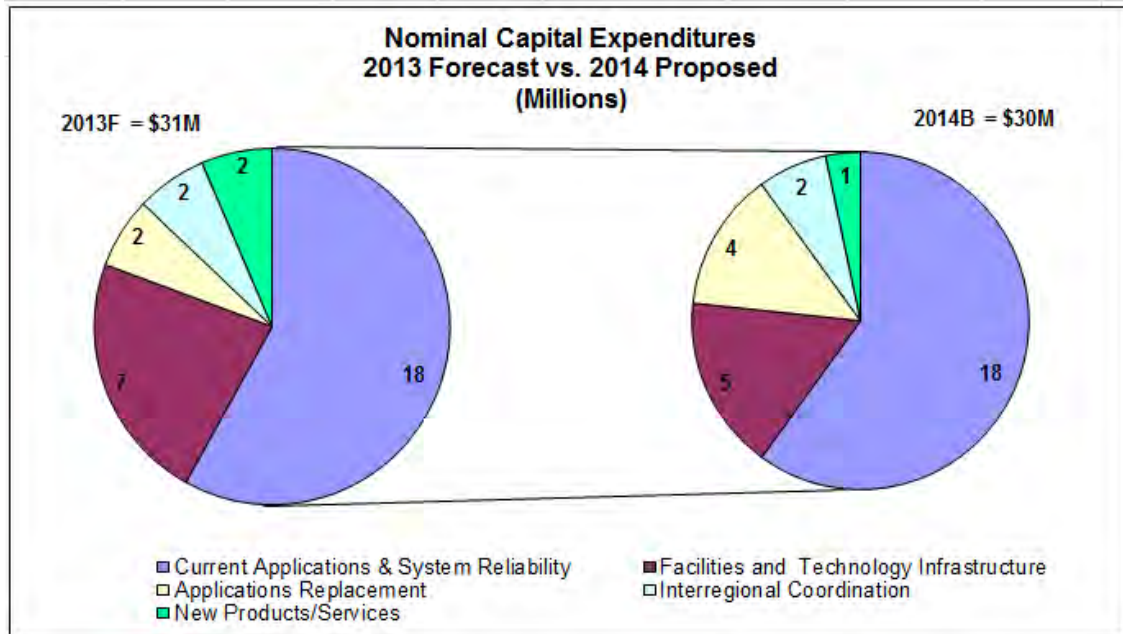
The Sector-Elected representatives of the PJM Finance Committee recommend that the Board approve this expense budget while encouraging PJM Management to continue to seek and sustain cost-saving initiatives that enhance the efficiency, reliability, and effectiveness of PJM markets.

2. Proposed 2014 Capital Budget

PJM has proposed a capital budget of \$30 million for 2014. Year-over-year comparison to the 2013 forecast shows a decrease of \$1 million or 3.2%. The comparisons are shown in the charts below:



Note: Excludes Valley Forge Retrofit and AC2 Rider as they are nearing completion and falling off the out years.



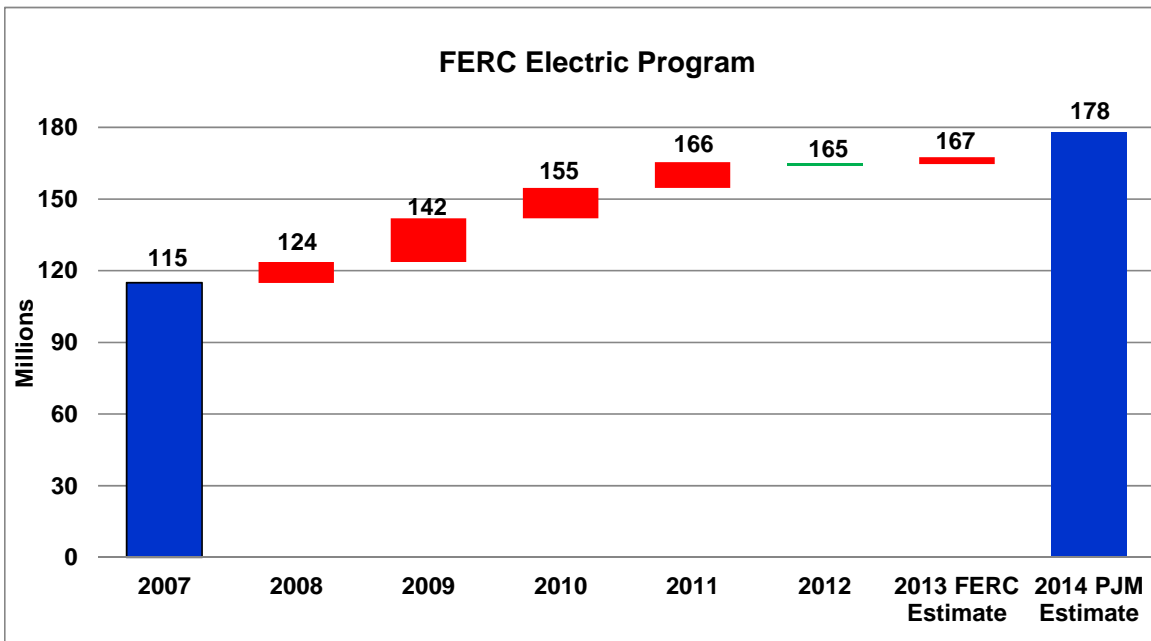
The above comparisons show that the nominal capital expenditures are consistent on a year-to-year basis. The capital analysis shown in the previous two charts is indicative of nominal capital spending, as capital investments exceptions such as AC2 and Valley Forge Retrofit have come to a close. It is anticipated that nominal capital expenditures on a go forward basis will be in the range of \$25-\$35M annually.

The Sector-Elected representatives of the PJM Finance Committee recommend that the Board approve the proposed \$30 million capital budget for 2014.

3. Proposed Schedule 9-FERC Rate for 2014

PJM has proposed a Schedule 9-FERC rate of \$0.0712 per MWh of load for 2014 relative to PJM’s projected transmission usage of 875 terawatt-hours for 2014. The 2013 9-FERC rate is \$0.0595 per MWh. The allocation of FERC Fees to the PJM membership has grown due to the integrations over the past 8 to 10 years, i.e. Duke, ATSI, EKPC, etc. The cost of FERC’s Electric program has seen significant growth since the inception of the new billing methodology in

2002. The growth has tapered off significantly in the last three years. While the CAGR shows a significant growth rate of 6.4%, we can see over the last four years that the rate of growth is slowing and that four year CAGR is only 2.7%. Also, the 2014 Schedule 9-FERC rate includes an expected under-collection in 2013 of these funds from the PJM membership.

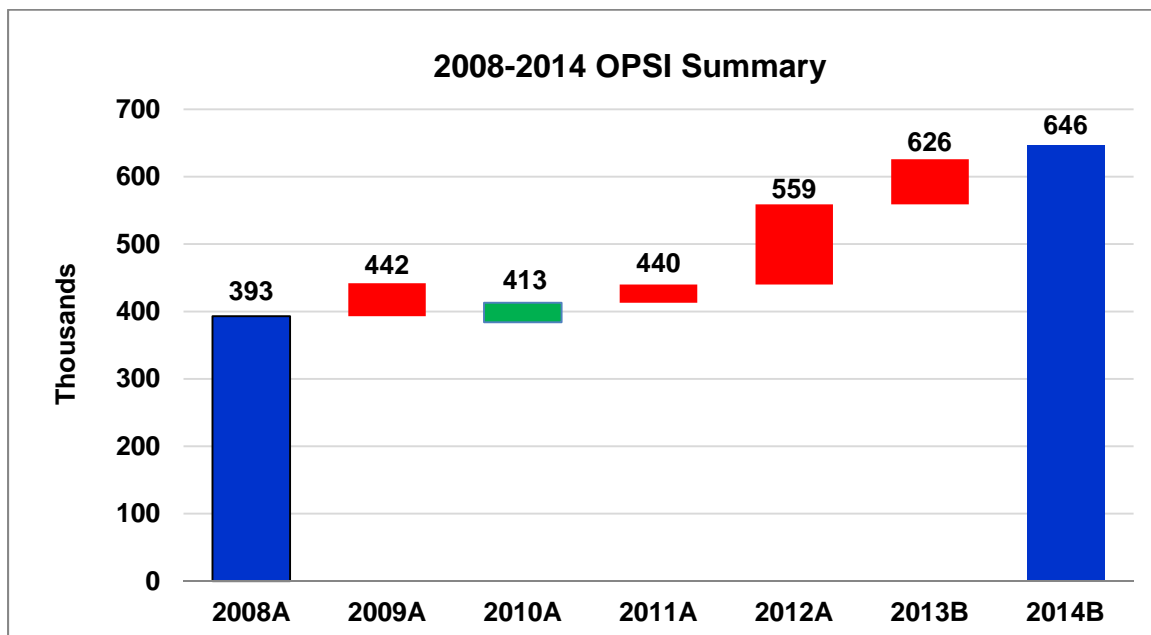


Given the change in growth pattern over the last 4 years, combined with the expansion of PJM, previous concerns of "over-taxation" seem to have averted.

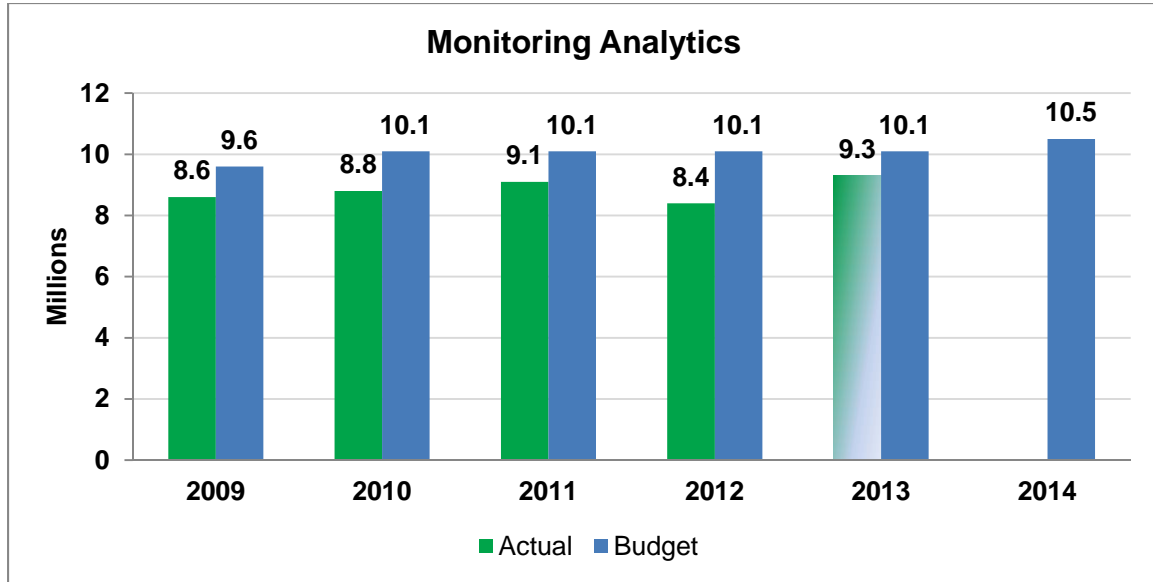
The Sector-Elected representatives of the PJM Finance Committee recommend that the Board approve the proposed rate.

4. Proposed Schedule 9-OPSI Rate for 2014

OPSI presented its approved budget of \$646,000 for 2014, an increase of \$19,925 or 3.2% over the 2013 budget of \$626,075. Since this budget increase is below the 15% threshold requiring FERC review and approval, the Sector-Elected Representatives of the PJM Finance Committee must accept OPSI's budget for 2014. Despite their representation of cost concerns, it should be noted that since 2008, OPSI's annual expense has increased from an actual of \$393,000 to a 2014 proposed budget of \$646,000, representing a CAGR of 8.6% as compared with an approximate 1.6% CAGR for the same period based on the Consumer Price Index, a somewhat hidden attribute. PJM continues to be a "Tax Collector" for OPSI and the Sector-Elected Representatives of the PJM Finance Committee again 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.



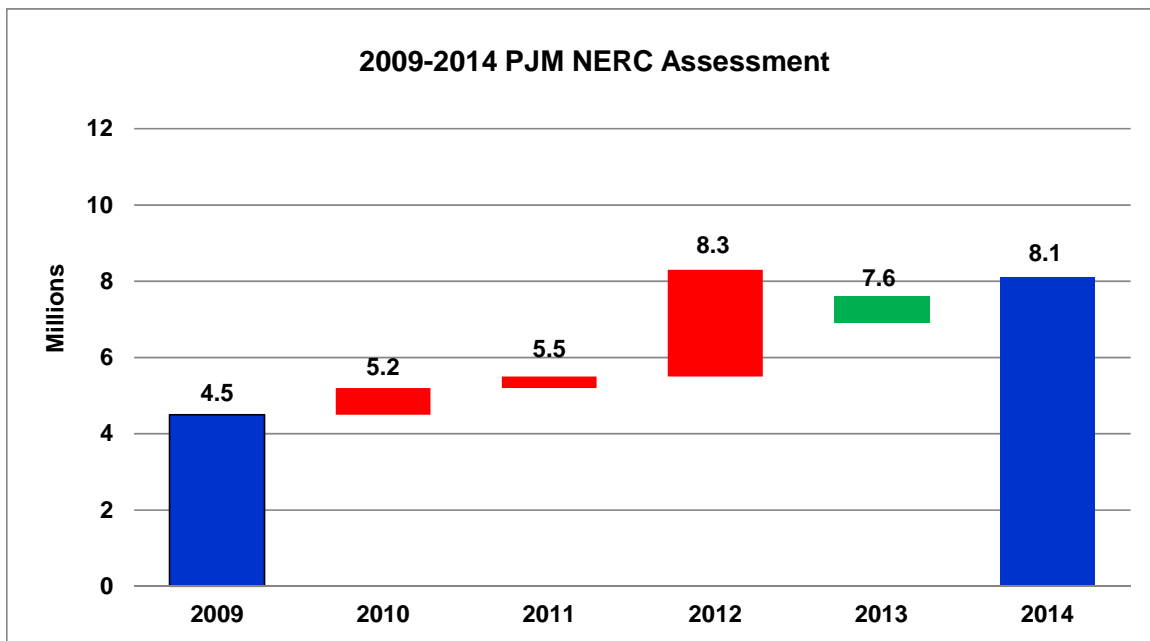
5. Proposed Schedule 9-MMU Rate for 2014



As shown in the above graph, the Monitoring Analytics budget has remained nearly flat since its inception in 2009 and is projected to increase slightly in 2014 to \$10.5M. In fact, the CAGR for MA actuals from 2009 to 2013 is only 2.0%. (Please note that 2013 is the current year-end forecast). The increase in the 2014 budget relative to the 2013 budget is 4% and 12.9% above projected actual expenses for 2013, driven by additional capital purchases and pension obligations. It is noteworthy to mention that membership pays for depreciation of capital purchases in the expense budget. Only the depreciation component of the capital purchases factors into this year's expense budget. Going forward, we may want to separate the expense from the capital budget. If MA follows its historical trend, there is reason to expect that the 2014 actual will be approximately \$9.4M, again remaining essentially flat. There were no extraordinary issues of concern to the committee and the Sector-Elected Representatives of the PJM Finance Committee accept Monitoring Analytics' budget for 2014.

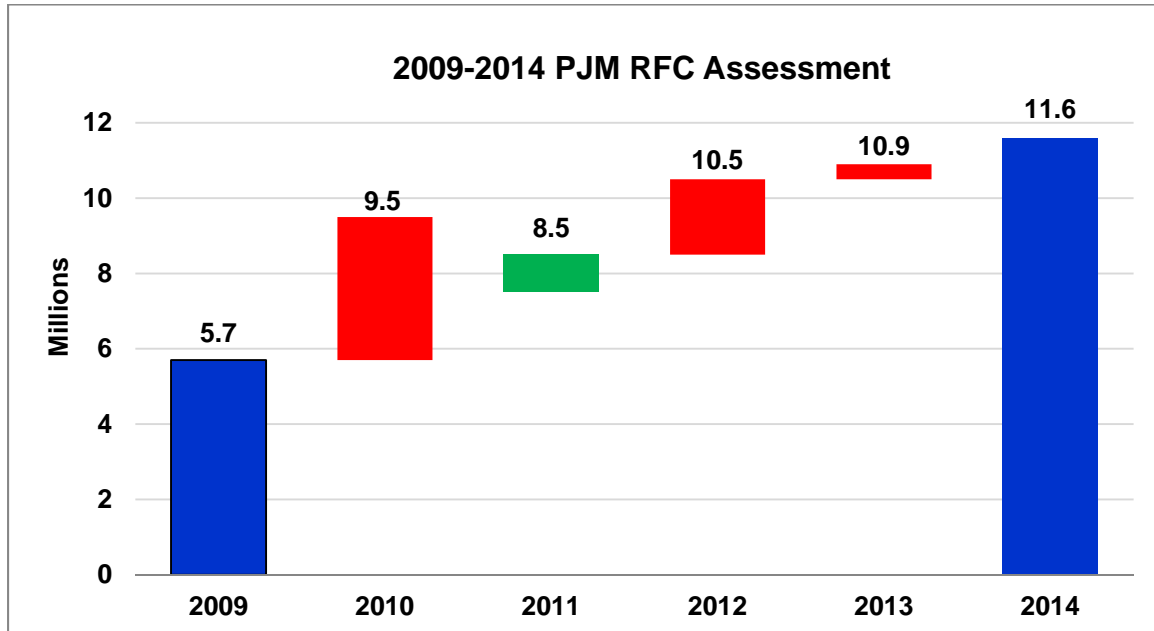
6. Proposed Schedule 10 for NERC and RFC Budget

The NERC 2014 assessment to PJM members is proposed to increase \$0.5M, however, the budget has a CAGR of 12.5% over the last 5 year interval, as compared with an approximate 1.6% 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. While NERC has responded with a number of cost control efforts and PJM's footprint has increased, questions remain when coupled with the RE (Regional Entity) increases for the same purported reason. The rate of increase is illustrated in the chart below:



For the PJM RFC budget, the story is similar, although more acceptable. 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-year interval ending in 2014 is 15.3%, again, although high, more understandable than that associated with NERC.



Perhaps there are more pertinent questions to be asked in the NERC budgeting process that need answers. If the ERO has subjugated part of its obligations to RFC for its region, then why do we need duplicate workforce and systems for the same area? Also, are there any metrics that we can use for our customers to justify such extreme increases in expenditures?

The Sector-Elected Representatives of the PJM Finance Committee accept the NERC and RFC budgets with the recommendation that the Board again request PJM Management to continue dialogue with NERC and RFC pointing out the concern of the rate of increase in annual budgets vs. the benefits being derived.

7. Comments

PJM is expected to refund approximately \$6 million in 2014 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, additional responses to supplemental requests, independent financial and PJM's annual SSAE 16 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 continue to be concerned about what appears to be ever increasing expenses with regard to NERC and RFC. The representatives look forward to working with PJM management to find solutions to these continuing 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 2014 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