

October 3, 2014

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Subject: Finance Committee Recommendations

The Finance Committee met on August 13, 2014 and again on September 17, 2014 to review the proposed expense and capital budgets for 2015 as well as the proposed OPSI, NERC, RFC and Monitoring Analytics Budgets for 2015 and the Schedule 9-FERC rates for 2015.

In addition, the Committee reviewed PJM's projected expenses and revenues for 2014 through 2018, including the estimated impact on rates and the deferred regulatory accounts. Additionally, a presentation and review of the proposed capital projects for 2015 was made at the August 19, 2014 Members Committee Webinar, the September 2, 2014 Planning Committee, and the September 4, 2014 Operating meetings.

1. Proposed Expense Budget for 2015

PJM has proposed an expense budget of \$276 million for Stated Rate and the Advanced Control Center expenses in 2015. 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.

Last year, PJM proposed, and the PJM Board of Managers ("Board") approved, an expense budget of \$276 million for 2014. Current forecasts predict PJM's actual expenses will be \$271 million for 2014, 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 2015 Capital Budget

PJM has proposed a capital budget for 2015 of \$30 million, the same amount as approved for 2014. It is anticipated that nominal capital expenditures on a going forward basis will be in the range of \$25-\$35 million annually.

The Sector-Elected representatives of the PJM Finance Committee recommend that the Board approve the proposed \$30 million capital budget for 2015.

3. Proposed Schedule 9-FERC Rate for 2015

PJM has proposed a Schedule 9-FERC rate of \$0.0670 per MWh of load for 2015 relative to PJM's projected transmission usage of 861 terawatt-hours for 2015. The

2014 Schedule 9-FERC rate is \$0.0702 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. Given the change in growth pattern over the last four 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 2015

OPSI presented its approved budget of \$646,000 for 2015, which represents no increase from 2014. Any OPSI budget increase in excess of 15 percent requires FERC review and approval. Since there is no increase, the Sector-Elected Representatives of the PJM Finance Committee must accept OPSI's budget for 2015. We appreciate OPSI's efforts to control expenses and trust that they will continue to do so.

5. Proposed Schedule 9-MMU Rate for 2015

The Monitoring Analytics budget was nearly flat from 2010 to 2014. For 2015, the Monitoring Analytics budget is projected to increase approximately 10.5 percent to \$11.6 million, or about 24.5 percent above 2014 projected expenses. The increase in the total budget is primarily driven by changes in compensation, including pension, medical, merit increases, non-employee labor costs, and increased depreciation costs along with the addition of two full-time employees. Monitoring Analytics' budget routinely exceeds the prior year's projected expenses. The main driver for the budget exceeding prior year's expenses is the asymmetrical risk related to managing expenses.

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. There were no extraordinary issues of concern to the committee and the Sector-Elected Representatives regarding Monitoring Analytics' budget for 2015.

6. Proposed Schedule 10 for NERC and RFC Budget

The NERC 2015 assessment to PJM members is proposed to increase \$0.6 million. 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.

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 Sector-Elected Representatives of the PJM Finance Committee accept the NERC and RFC budgets.

7. Comments

PJM is expected to refund approximately \$6 million in 2015 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.

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 2015 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