

September 30, 2015

PJM Board of Managers:

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Subject: Finance Committee Recommendations

The Finance Committee met on August 26, 2015 and again on September 17, 2015 to review the proposed 2016 expense and capital budgets as well as the proposed 2016 OPSI, NERC, RFC and Monitoring Analytics Budgets and the 2016 Schedule 9-FERC rates.

In addition, the Committee reviewed PJM's projected expenses and revenues for 2015 through 2019, including the estimated impact on rates and the deferred regulatory accounts. Additionally, a presentation and review of the proposed capital projects for 2016 was made at the August 27, 2015 Markets and Reliability Committee meeting, the September 8, 2015 Operating Committee, and the September 10, 2014 Planning Committee meeting.

1. Proposed Expense Budget for 2016

PJM has proposed an expense budget of \$280 million for its Stated Rate and the Advanced Control Center expenses in 2016. The PJM Sector-Elected Finance Committee members appreciate PJM Management's efforts 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.

For 2015, PJM proposed, and the PJM Board of Managers ("Board") approved, an expense budget of \$276 million. Current forecasts predict PJM's actual expenses will be approximately \$276 million for 2015, which is in line with the original budget.

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 2016 Capital Budget

PJM has proposed a capital budget for 2016 of \$36 million. The \$6 million proposed increase from 2015 is primarily from the Application Replacement/Retrofit category, which involves system upgrades and the replacement of the Enterprise Service Bus platform. The next category of significant increase is the Facilities & Technology Infrastructure group, which is due to renovations to PJM's Technology Center and Infrastructure and Security system upgrades. It is anticipated that nominal capital expenditures on a going forward basis will be in the range of \$30-\$40 million annually.

The Sector-Elected representatives of the PJM Finance Committee recommend that the Board approve the proposed \$36 million capital budget for 2016.

3. Proposed Schedule 9-FERC Rate for 2016

PJM has proposed a Schedule 9-FERC rate of \$0.0651 per MWh of load for 2016 relative to PJM's projected transmission usage of 852 terawatt-hours for 2016. This represents a \$.0019 per MWh of load reduction in cost from the 2015 Schedule 9 FERC rate. The 2015 Schedule 9-FERC rate is \$0.0670 per MWh.

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

4. Proposed Schedule 9-OPSI Rate for 2016

OPSI presented its approved budget of \$658,900 for 2016, which represents a 2% increase from 2015. The primary increase is in the Salaries and Benefits section with a smaller increase in travel expenses. The increase in the cost to provide benefits is the main driver behind this change. Any OPSI budget increase in excess of 15 percent requires FERC review and approval. Since the increase is below the 15 percent threshold, the Sector-Elected Representatives of the PJM Finance Committee accepts OPSI's budget for 2016.

5. Proposed Schedule 9-MMU Rate for 2016

The Monitoring Analytics budget for 2015 increased approximately 10.5 percent to \$11.6 million, or about 24.5 percent above 2014 projected expenses. The 2016 Monitoring Analytics' proposed budget is \$12.4 million, a 7.3% increase from the 2015 budget and projected costs. The increase in the total budget is primarily driven by changes in non-employee labor costs, technology costs and increased depreciation costs. 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.

There were no extraordinary issues of concern to the committee and the Sector-Elected Representatives regarding Monitoring Analytics' budget for 2016.

6. Proposed Schedule 10 for NERC and RFC Budget

The NERC 2016 assessment to PJM members is proposed at \$9.1 million. The RFC 2016 assessment to PJM members is proposed at \$14.8 million. These amounts represent approximately 3.4% increases from the 2015 budget projections for both the NERC and RFC budgets.

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

7. Comments

PJM projects revenues to equal expense in 2016 and does not expect to issue a refund 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 analysis 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.

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 2016 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