

October 10, 2016

PJM Board of Managers:

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PJM Interconnection, LLC
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Subject: Finance Committee Recommendations

The Finance Committee met on August 24, 2016 and again on September 28, 2016 to review the proposed PJM 2017 expense and capital budgets as well as the proposed 2017 OPSI, NERC, RFC and Monitoring Analytics Budgets and the 2017 Schedule 9-FERC rates.

In addition, the Committee reviewed PJM's projected expenses and revenues for 2016 through 2020, including the estimated impact on rates and the deferred regulatory accounts. Additionally, a presentation and review of the proposed capital projects for 2017 was made at the September 13, 2016 Operating Committee and the September 15, 2016 Planning Committee meetings. An update on the 2017 budget was provided at the September 26, 2016 Members Committee Webinar as well.

1. Proposed Expense Budget for 2017

PJM has proposed an expense budget of \$287 million for its Stated Rate and the Advanced Control Center expenses in 2017. The PJM Sector-Elected Finance Committee members appreciate PJM Management's efforts to control the company's expenses and provide timely, accurate and highly usable financial analysis for the committee.

For 2016, PJM proposed, and the PJM Board of Managers ("Board") approved, an expense budget of \$280 million. Current forecasts project PJM's actual expenses will be approximately \$276 million for 2016, which is in line with the original budget.

The Sector-Elected representatives of the PJM Finance Committee recommend that the Board accepts the proposed 2017 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 2017 Capital Budget

PJM has proposed a capital budget for 2017 of \$38 million. The \$2 million proposed increase from 2016 is primarily from the Facilities & Technology Infrastructure group, which is due to renovations to PJM's Technology Center and Infrastructure 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 accepts the proposed \$38 million capital budget for 2017.

3. Proposed Schedule 9-FERC Rate for 2017

PJM has proposed a Schedule 9-FERC rate of \$0.0759 per MWh of load for 2017 relative to PJM's projected transmission usage of 855 terawatt-hours for 2017. This represents a \$0.0108 per MWh of load increase in cost from the 2016 Schedule 9 FERC rate. The 2016 Schedule 9-FERC rate is \$0.0651 per MWh.

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

4. Proposed Schedule 9-OPSI Rate for 2017

OPSI presented its approved budget of \$658,900 for 2017. The 2017 OPSI budget is equal to the 2016 approved OPSI budget. 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 2017.

5. Proposed Schedule 9-MMU Rate for 2017

The 2017 Monitoring Analytics' proposed budget is \$13.2 million, a 6.8% increase from the 2016 original budget and a 7.4% increase from the current projected costs for 2016. The increase in the total budget is primarily driven by changes in non-employee labor costs (particularly pension consulting expenses), data costs and increased depreciation costs. Monitoring Analytics' budget has increased annually since 2014. 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 2017.

6. Proposed Schedule 10 for NERC and RFC Budget

The NERC 2017 assessment to PJM members is proposed at \$9.3 million. The RFC 2017 assessment to PJM members is proposed at \$15.0 million. These amounts represent approximately 2.6% and 0.8% increases respectively from the 2016 budget projections for both the NERC and RFC assessments.

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

7. Comments

PJM projects expenses to exceed revenues in 2017 with the current stated rates 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 adopts the recommendation of the Finance Committee as described in the September 9, 2016 letter to the Board of Managers for a new stated rate for the time period beginning January 1, 2017 through December 31, 2026.

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 welcome 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 2017 budget by the Board. We stand ready to continue working with PJM Management to make oversight by the Finance Committee as effective and constructive as feasible.

Sincerely,

Sector-Elected Representatives to the Finance Committee