PJM INTERCONNECTION, L.L.C.

FOR THE QUARTER ENDED JUNE 30, 2015

INDEX

PART I . FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

PJM INTERCONNECTION, L.L.C.
Consolidated Statement of Financial Position
($ in thousands)

	Unaudited June 30, 2015	December 31, 2014
Assets		
Current assets:		
Deposits on hand	$ 1,087,231	$ 1,087,798
Operating cash	6,346	36,662
Receivables	34,619	31,459
Study and interconnection receivables	16,539	8,667
Prepaid expenses and other current assets	8,781	9,246
Prepaid income taxes	3,302	47
Deferred FERC fees	204	408
Deferred income taxes, net of valuation allowance	8,599	9,247
Note receivable	804	751
	1,166,425	1,184,285
Non-current assets:		
Fixed assets, net of accumulated depreciation and amortization of $546,324 and $524,503	150,674	162,800
Land	1,420	1,420
Projects in development	16,607	20,040
Deferred recovery of pension and postretirement costs	21,609	21,800
Deferred income taxes, net of valuation allowance	27,697	23,495
Note receivable	2,013	2,463
Other	19,526	15,941
	239,546	247,959
Total assets	$ 1,405,971	$ 1,432,244
Liabilities, paid in capital, retained earnings and accumulated other comprehensive income		
Current liabilities:		
Accounts payable and accrued expenses	$ 50,303	$ 35,636
Due to members	20,624	60,690
Study and interconnection payables	17,233	8,872
Accrued payroll and benefits	13,244	24,810
Current portion of long-term debt	12,852	12,852
Revolving line of credit	9,514	-
Current portion of capital lease	1,338	1,338
Deferred revenue	1,605	3,293
Postretirement healthcare benefits liability	964	916
Other employee benefits	639	640
Deposits	1,087,231	1,087,798
	1,215,547	1,236,845
Non-current liabilities:		
Long-term debt	28,495	34,922
Long-term capital lease	20,826	21,517
Deferred regulatory liability	10,591	11,388
Interest rate swap	1,418	1,479
Pension benefits liability	52,354	54,847
Postretirement healthcare benefits liability	49,652	48,124
Other employee benefits	19,660	16,043
	182,996	188,320
Total liabilities	1,398,543	1,425,165
Paid in capital	722	722
Retained earnings	6,137	5,788
Accumulated other comprehensive income	569	569
Total paid in capital, retained earnings and accumulated other comprehensive income	7,428	7,079
Total liabilities, paid in capital, retained earnings and accumulated other comprehensive income	$ 1,405,971	$ 1,432,244

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
($ in thousands)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	**2014**	**2015**	**2014**
Income				
Revenue:				
Service fees	$ 63,428	$ 70,303	$ 136,704	$ 148,842
Deferred regulatory income	4,634	(3,797)	1,018	(16,436)
FERC fee reimbursement	12,754	12,704	27,779	27,874
Study and interconnection fees	729	834	1,617	1,582
Interest income	166	114	407	356
Membership fees	840	815	1,733	1,612
Other income	800	877	1,457	1,471
Total revenue	83,351	81,850	170,715	165,301
Operating expenses:				
Compensation	29,761	29,291	62,837	59,089
FERC fees	12,754	12,704	27,779	27,874
Depreciation and amortization expense, including deferral recovery	13,772	14,204	27,499	28,530
Outside services	13,980	13,740	26,190	26,687
Software licenses and fees	3,402	3,182	7,333	6,005
Pension benefits	2,603	1,546	5,248	3,157
Other expense	3,553	2,432	5,101	4,423
Computer maintenance and office supplies	1,369	1,819	3,544	3,944
Study and interconnection services	729	834	1,617	1,582
Interest expense	141	848	936	1,600
Postretirement healthcare benefits	410	88	861	241
Lease expenses	334	525	679	1,058
Total operating expenses	82,808	81,213	169,624	164,190
Income before income taxes	543	637	1,091	1,111
Income tax expense	362	311	742	595
Net income	181	326	349	516
Other comprehensive income:				
Unrealized gain on securities, net of taxes	-	-	-	-
Comprehensive income, net	$ 181	$ 326	$ 349	$ 516
Paid in capital, retained earnings and accumulated other comprehensive income				
Beginning balance	$ 7,247	$ 6,211	$ 7,079	$ 6,021
Net income	181	326	349	516
Other comprehensive income	-	-	-	-
Ending balance	$ 7,428	$ 6,537	$ 7,428	$ 6,537

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

PJM INTERCONNECTION, L.L.C.
Consolidated Statement of Cash Flows
($ in thousands)

	(Unaudited) Six months ended June 30,	
	2015	**2014**
Cash flows from operating activities:		
Net income	$ 349	$ 516
Adjustments:		
Depreciation and amortization expense	27,499	28,530
Deferred income taxes, net of valuation allowance	(3,554)	(794)
Deferred recovery of pension and postretirement costs	191	(1,163)
Deferred regulatory liability	(797)	16,095
Employee benefit expense greater than funding	2,699	1,185
Net fair value changes related to interest rate swap	(61)	467
Changes in assets and liabilities:		
Increase in receivables	(3,160)	(1,418)
(Increase) decrease in interconnection receivables	(7,872)	35,907
(Increase) in prepaid expenses and other	(3,811)	(6,074)
(Increase) decrease in prepaid income taxes	(3,255)	745
Increase in accounts payable and accrued expenses	14,669	25,552
Increase (decrease) in interconnection payables	8,361	(37,101)
(Decrease) in accrued payroll and benefits	(11,566)	(9,077)
Decrease in deferred FERC fees	204	1,901
(Decrease) in deferred revenue	(1,688)	(1,507)
Refunds to members	-	(12,608)
Net cash provided by operating activities	18,208	41,156
Cash flows used in investing activities:		
Cost of projects in development	(11,942)	(15,371)
Note receivable	397	(3,191)
Net cash from investing activities	(11,545)	(18,562)
Cash flows from financing activities:		
Repayments under long-term debt	(6,427)	(6,428)
Borrowings under line of credit	9,514	689,632
Repayments under line of credit	-	(697,122)
(Decrease) increase in deposits on hand	(567)	262,400
(Decrease) in net due to members	(40,066)	(6,933)
Net cash used in financing activities	(37,546)	241,549
Net (decrease) increase in cash and cash equivalents	(30,883)	264,143
Cash and cash equivalents balance, beginning of period	1,124,460	876,375
Cash and cash equivalents balance, end of period	$ 1,093,577	$ 1,140,518
Noncash Activity:		
Changes in projects in development additions included in ending accounts payable and accrued expenses	$ (2)	$ 11

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, 2015 and for the three-months and six-months ended June 30, 2015 and June 30, 2014 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 2015 consolidated financial statements and footnotes.

PJM has performed an evaluation of subsequent events through July 28, 2015 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 the wholly-owned subsidiary 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 (FTR), revenue and expense, on a net basis in its consolidated financial statements.

2. Deferred Regulatory Liability

PJM recovers as service fees its administrative costs under its stated rate 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 six percent of its annual service fee revenues, less the revenue collected under the AC^2 rider and the PJM Settlement rate schedule, except for 2014 and every third year thereafter the financial reserve must be reduced to 2 percent of revenues under the stated rate tariff. The amount accumulated under the financial reserve provisions is classified as a non-current liability in the Company's Consolidated Statement of Financial Position. PJM refunds on a quarterly basis the deferred regulatory liability balance in excess of six percent of the annual revenue threshold. 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 2015 because expenses exceeded service fee revenues in those periods. For the three month period and six month period ended June 30, 2014, PJM made refunds of $2.3 million and $12.6 million, respectively.

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 or expense 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 revenues pursuant to the rate schedule 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, 2015, the deferred regulatory liability was $10.6 million. At December 31, 2014, the deferred regulatory liability was $11.4 million. The deferred regulatory liability for both periods is classified as a non-current liability representing PJM's reserve.

3. Note Receivable

On March 21, 2008, the FERC approved the 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. In March 2014 the original loan agreement was extended to March 31, 2020. The purpose of the loan 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, 2015 and December 31, 2014, the outstanding balance due from MA recorded by PJM as a note receivable was $2.8 million and $3.2 million, respectively. At June 30, 2015 and December 31, 2014, the current portion of the note receivable was $0.8 million and $0.7 million, respectively. The current balance at June 30, 2015 represents the amount to be repaid in the next twelve months. The non-current portion of the note receivable was $2.0 million $2.5 million at June 30, 2015 and December 31, 2014, respectively.

4. Short-Term Debt

PNC Revolving Line of Credit

PJM has a revolving credit agreement in the amount of $100 million with PNC Bank (PNC), which has been approved by the FERC. The facility expires March 30, 2016, and 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, 2015. At June 30, 2015, there was $9.5 million outstanding under the revolving credit agreement. At December 31, 2014, 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 London Interbank Offered Rate (LIBOR). At June 30, 2015 and December 31, 2014, the interest rate was 1.087 percent and 1.071 percent, respectively.

The facility also has a commitment fee of 10 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, 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 AC^2 property. The closing on this facility occurred on April 30, 2009.

On August 22, 2013, 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.

As of June 30, 2015 and December 31, 2014, outstanding borrowings under this loan were $24.0 million and $24.7 million, respectively. As part of the loan amendment, the interest rate is based on the LIBOR in effect at each reset date plus a spread of 110 basis points. The reset date is monthly. As of June 30, 2015 and December 30, 2014, the interest rate was 1.284 percent and 1.256 percent, respectively.

Under the loan agreement, PJM is required to meet certain financial and non-financial covenants. PJM was in compliance with these covenants as of June 30, 2015 and December 31, 2014.

Private Placement Loan Agreement

On March 28, 2008, the FERC approved PJM's application to borrow up to $115 million under a private placement master note agreement. On September 15, 2009, PJM issued senior unsecured notes with a seven-year term totaling $75 million. These notes bear interest at 3.60 percent per annum. Payments are due semi-annually on March 15 and September 15 with the first principal payment having been made on September 15, 2010. The notes mature on September 15, 2016.

As of June 30, 2015 and December 31, 2014, outstanding borrowings under the private placement were $17.3 million and $23.1 million, respectively. Under the loan agreement for the $75 million private placement, PJM is required to meet certain non-financial covenants. PJM was in compliance with these covenants as of June 30, 2015 and December 31, 2014.

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 a portion of 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 a new interest rate swap agreement with PNC on September 5, 2013. The interest rate swap agreement effectively fixes the interest payments on the Company's floating rate debt instrument at a rate of 3.95 percent through September 1, 2021. 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 to not 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 non-current liability section of the Consolidated Statement of Financial Position with changes in fair value recorded through earnings. Gains or losses on the interest rate swap are subject to recovery and refund under the AC^2 rider of the Tariff. At June 30, 2015 and December 31, 2014, the fair value of the swap was a liability of $1.4 million and $1.5 million, respectively.

The amount of the derivative (losses) gains PJM recognized in earnings is provided in the table below:

	Three months ended June 30, 2015	**Three months ended June 30, 2014**
Mark-to-market gains (losses), net	$ 340	$ (304)
Total net mark-to-market gains (losses), net	$ 340	$ (304)

	Six months ended June 30, 2015	**Six months ended June 30, 2014**
Mark-to-market gains (losses), net	$ 61	$ (467)
Total net mark-to-market gains (losses), net	$ 61	$ (467)

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

7. Derivative Financial Instrument – Financial Transmission Rights (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, 2015, was $794 million. A total of 214 members are FTR holders related to a total of 1,682,300 megawatt hours. As of June 30, 2015, PJM held $1,163.4 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, 2015:

($ in millions)	
Estimated fair value at April 1, 2015	$ 120
Auction results	979
Settlement and change in fair value	(305)
Estimated fair value at June 30, 2015	$ 794

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.

At June 30, 2015 and December 31, 2014, those financial assets and liabilities measured at fair value using Level 1 inputs were deposits on hand, operating cash and short-term debt. PJM's interest rate swap agreement associated with the bank loan from PNC has been accounted for at fair value on a recurring basis based on Level 2 inputs within the fair value hierarchy.

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.

9. Benefit Plans

	Pension Benefits				Other Post Retirement Benefits	
	Qualified		SERP*			
	2015	2014	2015	2014	2015	2014
Components of net periodic benefit cost for the period April 1 to June 30						
Service cost	$ 2,600	$ 1,944	$ 72	$ 63	$ 501	$ 401
Interest cost	1,866	1,698	62	58	522	486
Expected return on assets	(2,326)	(2,031)	-	-	(41)	(37)
Amortization of:						
Prior service cost	(5)	(5)	2	2	(322)	(322)
Actuarial loss (gain)	481	-	20	-	(81)	(257)
Total net periodic benefit cost	$ 2,616	$ 1,606	$ 156	$ 123	$ 579	$ 271

For each the of three months ended June 30, 2015 and June 30, 2014, $0.3 million and $0.4 million of total pension and postretirement benefits costs were included in capitalized project costs, respectively.

	Pension Benefits				Other Post Retirement Benefits	
	Qualified		SERP*			
	2015	2014	2015	2014	2015	2014
Components of net periodic benefit cost for the period January 1 to June 30						
Service cost	$ 5,201	$ 3,888	$ 144	$ 126	$ 1,001	$ 803
Interest cost	3,733	3,395	124	117	1,043	972
Expected return on assets	(4,652)	(4,061)	-	-	(81)	(74)
Amortization of:						
Prior service cost	(11)	(11)	5	5	(643)	(644)
Actuarial loss (gain)	961	-	40	-	(162)	(514)
Total net periodic benefit cost	$ 5,232	$ 3,211	$ 313	$ 248	$ 1,158	$ 543

For each the of six months ended June 30, 2015 and June 30, 2014, $0.6 million and $0.6 million of total pension and postretirement benefits costs were included in capitalized project costs, respectively.

	Pension Benefits				Other Post Retirement Benefits	
	Qualified		SERP*			
	2015	2014	2015	2014	2015	2014
Assumptions used to determine net periodic benefit cost as of June 30						
Discount rate	4.10%	4.95%	4.10%	4.95%	4.10%	4.95%
Expected return on plan assets	7.00%	7.00%	N/A	N/A	7.00%	7.00%
Rate of compensation increase	4.50%	4.50%	4.50%	4.50%	N/A	N/A
Health care cost trend on covered charges:	N/A	N/A	N/A	N/A		
Current					7.20%	7.40%
Ultimate					4.50%	4.50%
Years to ultimate					14	15

*Supplemental Executive Retirement Plan

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,	
	2015	2014
Income tax at the federal statutory rate	$ 382	$ 377
Increase resulting from:		
State income taxes net of federal tax benefit	106	57
Permanent items	187	132
Other	67	29
Income tax expense	$ 742	$ 595

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 2011 for Federal purposes and state purposes. There are no ongoing income tax audits at this time.

11. Commitment and Contingencies

Other Items

<u>*Lehman Brothers Commodities Services Default*</u>

On and before September 15, 2008, the activity in the PJM markets of Lehman Brothers Commodities Services (LBCS), a PJM member, was supported by a guaranty issued by the parent company of LBCS, Lehman Brothers Holdings, Inc. (LBHI). On September 15, 2008, LBHI filed a petition in bankruptcy in the U.S. Bankruptcy Court for the Southern District of New York. PJM issued a collateral call to LBCS on September 15, 2008, given the adverse change to LBCS's guarantor. LBCS did not meet its collateral call, and on September 18, 2008, LBCS was declared to be in default of its obligations, and its transaction rights in PJM were terminated. LBCS ultimately filed its own bankruptcy petition on October 3, 2008. LBCS did not pay their regular monthly invoices for market activity from August 2008 through and including May 2009, for a total of approximately $18 million. The aggregate payment defaults were billed to non-defaulting members in accordance with the default allocation assessment formula in PJM's Operating Agreement. LBCS has not had any open positions with the Company since June 1, 2009. On September 18, 2009, PJM filed Proofs of Claim, along with supporting documentation, with the Bankruptcy Court setting forth PJM's creditor claim against both LBCS and LBHI.

On December 18, 2012, PJM reached an agreement with Lehman's bankruptcy plan administrator to allow and approve $17 million of PJM's original claim. PJM's original claim was reduced on the basis that Lehman challenged PJM's right to set-off certain amounts from the claim that were due to Lehman prior to bankruptcy and because several PJM Members utilized their portion of the PJM assessed default allocation payment to set-off amounts they owed to Lehman. As a result of the agreement, PJM qualified for distributions from the Lehman bankruptcy estate beginning in April 2013. Through the second quarter of 2015, PJM has received approximately $16.4 million, or 96 percent, of PJM's approved claim from the Lehman estate. PJM expects to receive additional smaller distributions as the remaining net assets in this bankruptcy estate are liquidated.

<u>*Marginal Line Loss Surplus Payment Re-allocation*</u>

Between July 17, 2012 and July 20, 2012, fourteen companies defaulted on payment obligations totaling $28.0 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 is considering all alternatives to enforce its contract rights from all non-paying companies, and to this end, has 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 $4.25 million.

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.

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.

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 (RTO) 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's 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

PJM's service fees decreased $6.9 million, or 10 percent, to $63.4 million for the three months ended June 30, 2015 compared with the three months ended June 30, 2014; and decreased $12.1 million, or 8 percent, to $136.7 million for the six months ended June 30, 2015 compared with the six months ended June 30, 2014. The decrease is primarily attributable to lower trading activity. Transmission volume for the three and six months ended June 30, 2015 were 192 terawatt hours (TWhs) and 418 TWhs as compared with 195 TWhs and 424 TWhs for the three and six months ended June 30, 2014.

Total expenses, excluding FERC fees, study and interconnection services, interest expense and income taxes, increased $2.4 million, or 4 percent, to $69.2 million for the three months ended June 30, 2015 as compared with the three months ended June 30, 2014; and $6.2 million or 5 percent, to $139.3 for the six months ended June 30, 2015 as compared with the six months ended June 30, 2014. The $3.7 million increase in compensation is primarily due to the timing of labor being capitalized for projects and annual merit increases. The $2.7 million increase in pension and postretirement expense is primarily due to the effect of the decrease in the discount rate used to measure the associated liabilities effective December 31, 2014.

Liquidity and Capital Resources

PJM has a revolving credit agreement with PNC Bank (PNC) for $100 million, which expires on March 30, 2016. At June 30, 2015, there was $9.5 million outstanding 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, 2015 the outstanding borrowings under the amended loan were $24.0 million.

On March 28, 2008, FERC approved PJM's application to borrow up to $115 million under a private placement master note agreement. On September 15, 2009, PJM issued senior unsecured notes with a seven-year term totaling $75 million. As of June 30, 2015, outstanding borrowings were $17.3 million. The purpose of this borrowing was to fund the technology investment in AC^2. There is no additional borrowing capacity under this facility.

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 risks 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 months ended June 30, 2015, fifty percent of PJM's service fees were billed to twenty of its members, each of which has an investment grade credit rating per the Standard & Poor's rating service. 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.

Lehman Brothers Commodities Services Default

On and before September 15, 2008, the activity in the PJM markets of Lehman Brothers Commodities Services (LBCS), a PJM member, was supported by a guaranty issued by the parent company of LBCS, Lehman Brothers Holdings, Inc. (LBHI). On September 15, 2008, LBHI filed a petition in bankruptcy in the U.S. Bankruptcy Court for the Southern District of New York. PJM issued a collateral call to LBCS on September 15, 2008, given the adverse change to LBCS's guarantor. LBCS did not meet its collateral call, and on September 18, 2008, LBCS was declared to be in default of its obligations, and its transaction rights in PJM were terminated. LBCS ultimately filed its own bankruptcy petition on October 3, 2008. LBCS did not pay their regular monthly invoices for market activity from August 2008 through and including May 2009, for a total of approximately $18 million. The aggregate payment defaults were billed to non-defaulting members in accordance with the default allocation assessment formula in PJM's Operating Agreement. LBCS has not had any open positions with the Company since June 1, 2009. On September 18, 2009, PJM filed Proofs of Claim, along with supporting documentation, with the Bankruptcy Court setting forth PJM's creditor claim against both LBCS and LBHI.

On December 18, 2012, PJM reached an agreement with Lehman's bankruptcy plan administrator to allow and approve $17 million of PJM's original claim. PJM's original claim was reduced on the basis that Lehman challenged PJM's right to set-off certain amounts from the claim that were due to Lehman prior to bankruptcy and because several PJM Members utilized their portion of the PJM assessed default allocation payment to set-off amounts they owed to Lehman. As a result of the agreement, PJM qualified for distributions from the Lehman bankruptcy estate beginning in April 2013. Through the second quarter of 2015, PJM has received approximately $16.4 million, or 96 percent, of PJM's approved claim from the Lehman estate. PJM expects to receive additional smaller distributions as the remaining net assets in this bankruptcy estate are liquidated.

Marginal Line Loss Surplus Payment Re-allocation

Between July 17, 2012 and July 20, 2012, fourteen companies defaulted on payment obligations totaling $28.0 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 is considering all alternatives to enforce its contract rights from all non-paying companies, and to this end, has 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 $4.25 million.

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.