PJM INTERCONNECTION, L.L.C.

FOR THE QUARTER ENDED SEPTEMBER 30, 2018

INDEX

PART I . FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

PJM INTERCONNECTION, L.L.C.
Consolidated Statement of Financial Position (Unaudited)

dollars in thousands	September 30, 2018	December 31, 2017
Assets		
Current assets:		
Deposits on hand	$ 1,684,212	$ 1,458,744
Operating cash	396,562	308,321
Receivables	39,102	93,815
Study and interconnection receivables	11,123	7,065
Prepaid income taxes	11,700	17,968
Deferred FERC fees	557	2,229
Prepaid expenses and other	9,579	11,337
Note receivable	198	2,158
	2,153,033	1,901,637
Non-current assets:		
Fixed assets, net of accumulated depreciation and amortization of $665,325 and $630,398	97,489	113,111
Land	1,420	1,420
Projects in development	33,006	22,710
Deferred recovery of pension and postretirement costs	38,459	38,617
Deferred income taxes, net of valuation allowance	27,389	22,646
Note receivable	1,518	1,025
Other	24,617	23,172
	223,898	222,701
Total assets	$ 2,376,931	$ 2,124,338
Liabilities, paid-in capital, retained earnings and accumulated other comprehensive income		
Current liabilities:		
Accounts payable and accrued expenses	$ 14,985	$ 29,197
Due to members	464,794	397,396
Study and interconnection payables	11,082	7,134
Accrued payroll and benefits	26,121	30,506
Current portion of long-term debt	2,886	1,317
Current portion of capital lease	1,688	1,631
Deferred regulatory liability	11,652	132
Deferred revenue	937	3,387
Postretirement health care benefits liability	1,353	1,241
Other employee benefits	279	164
Deposits	1,684,212	1,458,744
	2,219,989	1,930,849
Non-current liabilities:		
Long-term debt	17,314	19,429
Long-term capital lease	15,502	16,774
Deferred regulatory liability	17,843	9,777
Interest rate swap	82	540
Pension benefits liability	13,965	60,935
Postretirement health care benefits liability	52,394	49,746
Other employee benefits	30,470	27,698
	147,570	184,899
Total liabilities	2,367,559	2,115,748
Commitments and contingencies (Note 11)		
Paid-in capital	722	722
Retained earnings	7,689	7,197
Accumulated other comprehensive income	961	671
Total paid-in capital, retained earnings and accumulated other comprehensive income	9,372	8,590
Total liabilities, paid-in capital, retained earnings and accumulated other comprehensive income	$ 2,376,931	$ 2,124,338

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 (Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
dollars in thousands	**2018**	**2017**	**2018**	**2017**
Income				
Operating revenue				
Service fees	$ 83,181	$ 80,807	$ 234,051	$ 232,796
Deferred regulatory income	(11,408)	(13,016)	(21,757)	(25,322)
FERC fees reimbursement	17,499	16,447	48,587	46,268
Study and interconnection fees	944	915	2,957	2,909
Membership fees	925	871	2,739	2,587
Other	801	706	3,643	1,900
Total operating revenue	91,942	86,730	270,220	261,138
Operating expenses				
Compensation	36,230	32,723	105,099	99,441
FERC fees	17,499	16,447	48,587	46,268
Outside services	13,179	13,354	40,635	41,580
Depreciation and amortization	11,929	11,192	35,328	33,874
Software licenses and fees	4,877	3,410	13,168	11,678
Other expenses	2,750	2,547	10,002	7,720
Pension benefits	1,923	2,054	5,985	6,468
Computer maintenance and office supplies	1,178	2,455	5,015	6,413
Study and interconnection services	944	915	2,957	2,909
Lease expenses	490	529	1,428	1,627
Postretirement health care benefits	393	335	1,179	1,049
Total operating expenses	91,392	85,961	269,383	259,027
Operating income	550	769	837	2,111
Other income (expense)				
Interest income	4,273	1,476	9,386	3,733
Interest expense	4,437	1,593	9,056	4,007
Total other income (expense)	(164)	(117)	330	(274)
Income before income taxes	386	652	1,167	1,837
Income tax expense	243	493	675	1,423
Net income	$ 143	$ 159	$ 492	$ 414
Paid-in capital, retained earnings and accumulated other comprehensive income				
Beginning balance	9,184	8,422	8,590	8,098
Net income	143	159	492	414
Other comprehensive income	45	21	290	90
Ending balance	$ 9,372	$ 8,602	$ 9,372	$ 8,602

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

PJM INTERCONNECTION, L.L.C.
Consolidated Statement of Cash Flows (Unaudited)

dollars in thousands	Nine months ended September 30, 2018	Nine months ended September 30, 2017
Cash flows from operating activities:		
Net income	$ 492	$ 414
Adjustments:		
Depreciation and amortization expense	35,328	33,874
Deferred income taxes, net of valuation allowance	(4,743)	(5,210)
Deferred recovery of pension and postretirement costs	158	158
Deferred regulatory liability	21,775	25,321
Employee benefit expense (less than) funding	(41,323)	(915)
Net fair value changes related to interest rate swap	(458)	(227)
Changes in assets and liabilities:		
Decrease (increase) in receivables	54,713	(2,437)
(Increase) decrease in study and interconnection receivables	(4,058)	6,214
Decrease in prepaid expenses and other	(612)	(4,903)
Decrease in deferred FERC fees	1,672	1,555
Decrease in prepaid income taxes	6,268	292
Decrease in accounts payable and accrued expenses	(15,706)	(17,374)
Increase (decrease) in study and interconnection payables	3,948	(6,082)
Decrease in accrued payroll and benefits	(4,385)	(2,772)
Decrease in deferred revenue	(2,450)	(2,343)
Refunds to members	(2,189)	(3,855)
Net cash provided by operating activities	48,430	21,710
Cash flows from investing activities:		
Cost of projects in development	(28,508)	(28,451)
Note receivable	1,467	2,085
Net cash (used in) investing activities	(27,041)	(26,366)
Cash flows from financing activities:		
Borrowings under line of credit	452,855	403,207
Repayments under line of credit	(452,855)	(403,207)
Borrowings of long-term debt	20,200	-
Repayments of long-term debt	(20,746)	(988)
Increase (decrease) in due to members	67,398	(89,078)
Increase (decrease) in deposits	225,468	(20,280)
Net cash provided by (used in) financing activities	292,320	(110,346)
Net increase (decrease) in cash and cash equivalents	313,709	(115,002)
Cash and cash equivalents balance (including customer deposits), beginning of period	1,767,065	1,894,375
Cash and cash equivalents balance (including customer deposits), end of period	$ 2,080,774	$ 1,779,373
Noncash activity:		
Projects in development additions included in ending accounts payable and accrued expenses	$ 1,494	$ 1,249

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

Notes to Consolidated Financial Statements
(dollars in tables in thousands)
(Unaudited)

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 September 30, 2018 and for the three-month and nine-month periods ended September 30, 2018 and September 30, 2017 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 2017 consolidated financial statements and footnotes.

PJM has performed an evaluation of subsequent events through November 8, 2018, 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 its wholly-owned subsidiary, PJM Settlement, Inc. (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 (FTRs), revenue and expense, on a net basis in its consolidated financial statements.

Accounting Standards Not Yet Adopted
In August 2018, the Financial Accounting Standards Board (FASB) amended its authoritative guidance on the disclosures required for employers that sponsor defined benefit pension or postretirement plans. The amended guidance removes several disclosures the FASB deemed unnecessary while also adding new disclosure requirements. For PJM, the disclosure of the effects of a one-percentage-point change in assumed heath care cost trend rates on the postretirement benefit obligation will no longer be required. The new disclosure requirements are not applicable for PJM. The amended guidance is effective for annual periods ending after December 15, 2021, with early adoption permitted. PJM intends to early adopt this disclosure guidance at December 31, 2018. Adoption of the amended guidance will not affect the Company's Consolidated Statement of Financial Position, Consolidated Statement of Income, Comprehensive Income and Paid-In Capital, Retained Earnings and Accumulated Other Comprehensive Income, and the Consolidated Statement of Cash Flows.

2. Deferred Regulatory Liability

PJM recovers as service fees its administrative costs through a stated rate mechanism under the Company's Open Access Transmission Tariff (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 6 percent of its annual stated rates revenues, except that beginning for 2020 and every third year thereafter, the financial reserve must be reduced to 2 percent of annual stated rate revenues. The amount accumulated under the financial reserve provision is classified as a non-current liability in the Company's Consolidated Statement of Financial Position. On a quarterly basis, PJM refunds the deferred regulatory liability balance in excess of the permitted financial reserve for the previous quarter. 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. During the first nine months of 2018 and 2017, PJM made refunds of $2.2 million and $3.8 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 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 service fee revenues pursuant to the rate schedules 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 September 30, 2018 and December 31, 2017, the deferred regulatory liability balance was $29.5 million and $9.9 million, respectively. At September 30, 2018, the current portion of the deferred regulatory liability was $11.7 million to be refunded to members by PJM and PJM Settlement during fourth quarter 2018. At December 31, 2017, the current portion of the deferred regulatory liability was $0.1 million, representing PJM Settlement's expected refunds to members during the subsequent quarter, respectively. The non-current portion of the deferred regulatory liability of $17.8 million and $9.8 million represent the amount of PJM's reserve at September 30, 2018 and December 31, 2017, respectively.

3. Note Receivable

On March 21, 2008, the FERC approved a 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 revolving loan agreement with MA during March 2008. The original revolving loan agreement was extended in March 2014 to March 31, 2020.

The purpose of the PJM revolving loan to MA 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 revolving loan has a capacity of $11 million and is secured by MA's accounts receivable and future collections of accounts receivable. At September 30, 2018 and December 31, 2017, the interest rate on the revolving loan agreement between PJM and MA was 5.25 and 4.50 percent, respectively. The interest rate on all loan advances is equal to the PNC Bank Base Rate. The PNC Bank Base Rate is the highest of (A) the Prime Rate, (B) the sum of the Federal Funds Rate plus 50 basis points (0.50 percent), or (C) the sum of the Daily London Interbank Offered Rate (LIBOR) plus 100 basis points (1.0 percent).

At September 30, 2018 and December 31, 2017, the outstanding balance due from MA recorded by PJM as a note receivable was $1.7 million and $3.2 million, respectively. At September 30, 2018 and December 31, 2017, the current portion of the note receivable was $0.2 million and $2.2 million, respectively. The current balance at September 30, 2018, represents the amount to be repaid in the next twelve months. The non-current portion of the note receivable was $1.5 million and $1.0 million at September 30, 2018 and December 31, 2017, respectively.

4. Short-Term Debt

PNC Revolving Line of Credit

On March 1, 2018 PJM amended and restated the existing revolving credit agreement with PNC Bank (PNC) increasing the capacity from $100 million to $150 million. PJM received approval from the FERC to continue to borrow under this amended facility and to increase the unsecured promissory note on January 19, 2018. The facility expires on January 31, 2020, and can be extended automatically through February 28, 2021, with FERC authorization. The revolving line of credit 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 September 30, 2018. At September 30, 2018 and December 31, 2017, 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 LIBOR. At September 30, 2018 and December 31, 2017, the interest rate was 2.885 percent and 2.314 percent, respectively.

The newly amended facility also has a commitment fee of 6.25 basis points on the unused balance. This fee is calculated daily and paid quarterly.

5. Long-Term Debt

Bank of America (BoA) Bank Loan Agreement

On June 28, 2018, the FERC approved PJM’s request to refinance the Company’s bank loan with PNC through a new term loan from BoA. On July 20, 2018, PJM entered into a $20.2 million loan agreement with BoA. The loan has a 7-year term and is unsecured.

As of September 30, 2018, outstanding borrowings under this loan were $20.2 million. As defined in the loan agreement, the term loan bears interest at a rate per annum equal to the LIBOR rate plus a spread of 65 basis points (0.65 percent). As of September 30, 2018, the interest rate was 2.76 percent.

PNC Bank Loan Agreement

On March 31, 2009, the FERC approved PJM’s application to enter into a 7-year, $35 million loan agreement with PNC. Closing on this facility occurred on April 30, 2009. On August 22, 2013, the FERC approved PJM’s application to amend and refinance the loan agreement with PNC. The closing on this facility occurred on September 5, 2013 and extended the maturity of the amended loan to September 1, 2021.

In conjunction with the establishment of the term loan with BoA, on July 19, 2018, PJM terminated the existing bank loan with PNC. PJM made a payment of $20.1 million to PNC in order to extinguish the PNC term loan and terminate the associated interest rate swap. For accounting purposes, this transaction was treated as an extinguishment of debt.

As of December 31, 2017, outstanding borrowings under this loan were $20.7 million. As defined in the loan agreement, the interest rate was based on the LIBOR in effect at each monthly reset date plus a spread of 75 basis points. As of December 31, 2017, the interest rate was 2.11 percent.

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 its variable rate debt using an interest rate swap, which is a derivative financial instrument.

To manage interest rate risk associated with the $20.2 million loan agreement with BoA, the Company entered into an interest rate swap agreement with BoA effective August 1, 2018. The interest rate swap agreement effectively fixes the interest payments of the Company's floating rate debt instrument at a rate of 3.62 percent. The term of the interest rate swap matches the term of the loan.

To manage interest rate risk associated with the amended loan agreement of $26.3 million with PNC, the Company entered into an interest rate swap agreement with PNC on September 5, 2013. The interest rate swap agreement effectively fixed the interest payments on the Company's floating rate debt. The April 2016 amendment of the loan agreement together with the interest rate swap reduced the effective interest rate on the outstanding principal amount of the loan from 3.95 percent to 3.60 percent. The term of the interest rate swap matched the term of the loan. PJM terminated the PNC interest rate swap agreement on July 19, 2018. Termination costs incurred by PJM were immaterial.

While PJM has entered into an economic hedge of its interest rate, the Company has elected not to 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 Consolidated Statement of Financial Position with changes in fair value recorded through earnings. At September 30, 2018 and December 31, 2017, the fair value of the swaps was a liability of $0.1 million and $0.5 million, respectively.

The amount of the derivative gains PJM recognized as interest expense in the Consolidated Statement of Income, Comprehensive Income and Paid-in Capital, Retained Earnings and Accumulated Other Comprehensive Income is provided in the table below:

	Three months ended	
	September 30, 2018	**September 30, 2017**
Unrealized mark-to-market gains	$ 34	$ 95
Total net mark-to-market gains	$ 34	$ 95

	Nine months ended	
	September 30, 2018	**September 30, 2017**
Unrealized and realized mark-to-market gains	$ 458	$ 227
Total net mark-to-market gains	$ 458	$ 227

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

7. Derivative Financial Instrument – 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 September 30, 2018, was $435 million. A total of 266 members were FTR holders related to a total of 2,786,623 megawatt hours. As of September 30, 2018, PJM held $1,622 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 September 30, 2018:

dollars in millions	
Balance at July 1, 2018	$ 618
Auction results	(51)
Settlement and change in fair value	(132)
Balance at September 30, 2018	$ 435

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.

The following table presents PJM's cash and cash equivalents as well as financial liabilities that were accounted for at fair value on a recurring basis as of September 30, 2018 and December 31, 2017 by level within the fair value hierarchy.

dollars in millions

	September 30, 2018				December 31, 2017
	Level 1	**Level 2**	**Level 3**	**Carrying Value**	**Carrying Value**
Cash and cash equivalents	$ 2,081	$ -	$ -	$ 2,081	$ 1,767
Deposit liabilities	1,684	-	-	1,684	1,458
Derivative liabilities	-	1	-	1	1

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. 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 and are not presented in the table above.

9. Benefit Plans

	Pension Benefits				**Other Postretirement Benefits**	
Components of Net Periodic Benefit Cost for the period July 1 to September 30	**Qualified**		**SERP***			
	2018	**2017**	**2018**	**2017**	**2018**	**2017**
Service cost	$ 2,696	$ 2,133	$ 92	$ 89	$ 421	$ 384
Interest cost	2,250	2,114	68	76	573	592
Expected return on assets	(3,718)	(2,621)	-	-	(167)	(116)
Prior service cost / (gain)	(5)	(5)	2	2	(322)	(322)
Actuarial loss / (gain)	542	256	91	99	(14)	(113)
Total net periodic benefit cost	$ 1,765	$ 1,877	$ 253	$ 266	$ 491	$ 425

**Supplemental Executive Retirement Plan*

For each of the three month periods ended September 30, 2018 and September 30, 2017, $0.2 million of total pension and postretirement benefits expense were included in capitalized project costs, respectively.

	Pension Benefits				**Other Postretirement Benefits**	
Components of Net Periodic Benefit Cost for the period January 1 to September 30	**Qualified**		**SERP***			
	2018	**2017**	**2018**	**2017**	**2018**	**2017**
Service cost	$ 8,261	$ 6,900	$ 272	$ 211	$ 1,274	$ 1,157
Interest cost	6,764	6,431	203	180	1,705	1,799
Expected return on assets	(11,162)	(7,951)	-	-	(500)	(348)
Prior service cost / (gain)	(14)	(14)	5	5	(965)	(965)
Actuarial loss / (gain)	1,663	843	257	165	(69)	(291)
Total net periodic benefit cost	$ 5,512	$ 6,209	$ 737	$ 561	$ 1,445	$ 1,352

For each of the nine month periods ended September 30, 2018 and September 30, 2017, $0.5 million and $0.6 million of total pension and postretirement benefits expense were included in capitalized project costs, respectively.

During first quarter of 2018, PJM contributed $50.0 million to its qualified defined benefit pension plan. This contribution resulted in the reduction of the Company's pension liability to $13.9 million at September 30, 2018.

Assumptions used to determine net periodic benefit cost as of Septmeber 30	**Pension Benefits**		**Postretirement**	
	2018	**2017**	**2018**	**2017**
Discount rate	3.70%	4.40%	3.70%	4.40%
Expected return on plan assets	6.60%	6.75%	6.60%	6.75%
Rate of compensation increase	4.50%	4.50%	N/A	N/A
Medical care cost trend rate				
Current (Pre-65)			6.93%	6.42%
Current (Post-65)			6.17%	7.37%
Ultimate (Pre-65)			4.45%	4.46%
Ultimate (Post-65)			4.46%	4.45%
Years to ultimate			20	21

10. Income Taxes

The income tax rate on PJM's operating activities differed from the federal statutory rate as follows:

	Nine months ended September 30,	
	2018	**2017**
Income tax expense at the federal statutory rate	$ 245	$ 643
Increase (decrease) resulting from:		
Change in valuation allowance	(12)	259
Permanent items	145	303
State income taxes, net of federal tax benefit	163	184
Tax credit arising from write-off of deferred tax asset	297	-
Other	(163)	34
Income tax expense	$ 675	$ 1,423

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 2014 for Federal purposes and state purposes. There are no ongoing income tax audits at this time.

11. Commitment and Contingencies

Other Items

Marginal Line Loss Surplus Payment Reallocation

Between July 17, 2012, and July 20, 2012, fourteen companies defaulted on payment obligations totaling $28 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 the Amended and Restated Operating Agreement of PJM (Operating Agreement) and Tariff, which was ordered by the FERC at Docket No. EL08-14 on July 21, 2011. PJM Settlement considered all alternatives to enforce its contract rights from all non-paying companies, and to this end, 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 million.

Several parties affected by the FERC's underlying ruling in this matter sought judicial review of the FERC's decision in the United States Court of Appeals for the District of Columbia Circuit and, in the ruling issued in August 2013, the court of appeals directed the FERC to provide additional support for its determination to recoup the previously ordered refunds. On February 20, 2014, the FERC issued an order establishing a schedule for parties to brief the issue of whether it should have ordered recoupment of the refunds. Initial briefs were submitted by several parties, including PJM, on April 7, 2014. Reply briefs were submitted by PJM and several parties on May 6-7, 2014. On November 19, 2015, the FERC issued an order affirming its decision ordering recoupment of refunds. On April 7, 2016, the FERC issued an order denying a rehearing request. On June 6, 2016, Energy Endeavors, L.P. filed a petition for review of the recoupment order in the United States Court of Appeals for the District of Columbia Circuit. On or about November 7, 2016, the FERC filed an unopposed motion and requested the court of appeals to remand the recoupment order. Energy Endeavors, L.P. did not oppose the motion. Accordingly, the court granted the FERC's motion and remanded the recoupment order on November 9, 2016 to the FERC. The recoupment order is thus before the FERC for additional proceedings and, at present, is not final.

The collection actions referenced above remain stayed in the Delaware courts. 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.

TranSource Matter

On June 23, 2015, TranSource, LLC (TranSource) filed a complaint (Complaint) against PJM with the FERC. In the Complaint, TranSource asked the FERC to order PJM to provide work papers used to determine the cost estimates for each individual system upgrade specified in System Impact Studies and to suspend all Tariff deadlines otherwise applicable to its Incremental Auction Revenue Rights (IARR) request, pending receipt of the demanded information. On September 24, 2015, the FERC issued an order (the September 24 Order) setting the Complaint for a trial-type evidentiary hearing. The FERC encouraged the parties to settle their disputes, held the hearing in abeyance and directed appointment of a settlement judge. As directed by the FERC, PJM, TranSource and the affected PJM transmission owners (which had intervened in the case), engaged in settlement discussions with the assistance of the assigned settlement judge. On February 10, 2016, while in settlement discussions, TranSource filed an amendment to the Complaint (the Amended Complaint). In the Amended Complaint, TranSource claims it incurred $72 million in lost profit opportunities from monthly IARRs during calendar year 2015. On February 25, 2016, the settlement judge declared an impasse and is expected to issue a report appointing a hearing judge. PJM believes the claim for monetary damages in the Amended Complaint is speculative and without merit because TranSource cannot show that PJM failed to meet any obligation owed to TranSource or that such alleged failure provides any basis to award TranSource monetary relief. Furthermore, as a signatory to the System Impact Study Agreement, TranSource expressly agreed that they are not entitled to consequential damages or lost profits from any asserted delay or non-performance by PJM or the associated transmission owner. PJM sought to dismiss the Amended Complaint with prejudice on procedural and substantive grounds. On March 22, 2016, the Chief Judge granted the motion filed by PJM and the PJM Transmission Owners to hold the proceeding in abeyance pending the Commission's decision on PJM's request for dismissal of the Amended Complaint.

On August 30, 2017, TranSource submitted a motion accepted by the Presiding Judge permitting a TranSource witness to testify at a hearing held in September 2017 regarding additional evaluations conducted based on the late presentation of the documents by one of the Interconnected Transmission Owners. Parties' initial post-hearing briefs were filed on October 2017 with reply briefs filed in November 2017. On January 19, 2018, the Administrative Law Judge assigned issued an initial decision finding that PJM's practices used to process TranSource's Upgrade Requests during the System Impact Study phase were nontransparent; and the impact of the system impact study phase, as applicable to TranSource was discriminatory under the Federal Power Act and therefore unjust and unreasonable. TranSource was granted limited relief, ordering PJM to restore TranSource's original queue position and refund the $0.15 million paid by TranSource for the study of its upgrade request. All other requests for relief were denied. PJM filed a brief on exceptions on February 20, 2018. A final decision will be issued by the Commission after considering all exception briefs filed. PJM does not believe that this matter will have a material adverse effect on its financial position, results of operations or cash flow.

Credit Matter

On June 22, 2018, PJM members were notified that GreenHat Energy, LLC defaulted on its obligations related to its FTR portfolio, which includes positions applicable to the current planning year as well as the 2019 – 2020 and 2020 – 2021 planning years. The default allocation assessments to the non-defaulting members for the period June through September 2018 are $49.5 million. PJM cannot predict the future default allocation assessments resulting from this default. The aggregate payment default of this member, net of collateral held, will be billed to the non-defaulting members in accordance with the default allocation assessment formula in the PJM Operating Agreement. PJM has implemented two significant FTR credit policy enhancements during 2018. Additional enhancements are anticipated during 2019. The outcome of the default is not anticipated to have an 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 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 Interconnection, L.L.C.'s (PJM or the Company) 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 and Expenses

PJM's service fees increased $2.4 million, or 3 percent, to $83.2 million for the three months ended September 30, 2018 compared with the three months ended September 30, 2017; and increased $1.3 million or 1 percent, to $234.1 million for the nine months ended September 30, 2018 compared with the nine months ended September 30, 2017. Transmission volume for the three and nine month periods ended September 30, 2018 were 228 terawatt hours (TWhs) and 635 TWhs as compared with 217 TWhs and 609 TWhs for the three and nine month periods ended September 30, 2017.

Total expenses, excluding FERC fees, study and interconnection services, interest expense and income taxes, increased $4.3 million, or 6 percent, to $72.9 million for the three month period September 30, 2018 as compared with the three month period ended September 30, 2017; and $7.9 million, or 4 percent, to $217.8 million for the nine months ended September 30, 2018 as compared with the nine months ended September 30, 2017. For the three month period ended September 30, 2018, year over year the increase in compensation expense is primarily due to increased headcount resulting from targeted contractor conversions to employees and normal cost of living adjustments. For the nine month period ended September 30, 2018, the increase in total expenses, excluding FERC fees, study and interconnection services, interest expense and income taxes, is due to increased headcount year over year resulting from contractor conversions to employees, normal cost of living adjustments and increased software subscriptions and cloud storage services.

Liquidity and Capital Resources

PJM has a revolving credit agreement with PNC Bank (PNC) for $150 million, which expires on January 31, 2020, and can be extended automatically through February 28, 2021. At September 30, 2018, there were no outstanding borrowings under the revolving credit agreement.

On June 28, 2018, the FERC approved PJM's request to refinance the Company's bank loan with PNC through a new term loan from Bank of America (BoA). On July 20, 2018, PJM entered into a $20.2 million loan agreement with BoA and made a payment of $20.1 million to PNC in order to extinguish the PNC term loan and terminate the associated interest rate swap. The new BoA term loan has a 7-year term and is unsecured.

As of September 30, 2018, outstanding borrowings under the BoA loan were $20.2 million. As defined in the loan agreement, the new term loan bears interest at a rate per annum equal to the LIBOR rate plus a spread of 65 basis points (0.65 percent). As of September 30, 2018, the interest rate was 2.76 percent.

To manage interest rate risk associated with the new $20.2 million loan agreement with BoA, the Company entered into an interest rate swap agreement with BoA effective August 1, 2018. The interest rate swap agreement effectively fixes the interest payments of the Company's floating rate debt instrument at a rate of 3.62 percent. The term of the interest rate swap matches the term of the loan.

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 issues 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 nine month period ended September 30, 2018, approximately sixty percent of PJM's service fees were billed to twenty-six of its members, each of which have an investment-grade credit rating according to at least one of three major rating services or have provided a guaranty from an affiliate with an investment-grade rating. 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.

Recent Regulatory Actions

<u>*Marginal Line Loss Surplus Payment Reallocation*</u>

Between July 17, 2012, and July 20, 2012, fourteen companies defaulted on payment obligations totaling $28 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 the Amended and Restated Operating Agreement of PJM (Operating Agreement) and Tariff, which was ordered by the FERC at Docket No. EL08-14 on July 21, 2011. PJM Settlement considered all alternatives to enforce its contract rights from all non-paying companies, and to this end, 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 million.

Several parties affected by the FERC's underlying ruling in this matter sought judicial review of the FERC's decision in the United States Court of Appeals for the District of Columbia Circuit and, in the ruling issued in August 2013, the court of appeals directed the FERC to provide additional support for its determination to recoup the previously ordered refunds. On February 20, 2014, the FERC issued an order establishing a schedule for parties to brief the issue of whether it should have ordered recoupment of the refunds. Initial briefs were submitted by several parties, including PJM, on April 7, 2014. Reply briefs were submitted by PJM and several parties on May 6-7, 2014. On November 19, 2015, the FERC issued an order affirming its decision ordering recoupment of refunds. On April 7, 2016, the FERC issued an order denying a rehearing request. On June 6, 2016, Energy Endeavors, L.P. filed a petition for review of the recoupment order in the United States Court of Appeals for the District of Columbia Circuit. On or about November 7, 2016, the FERC filed an unopposed motion and requested the court of appeals to remand the recoupment order. Energy Endeavors, L.P. did not oppose the motion. Accordingly, the court granted the FERC's motion and remanded the recoupment order on November 9, 2016 to the FERC. The recoupment order is thus before the FERC for additional proceedings and, at present, is not final.

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