PJM INTERCONNECTION, L.L.C.

FOR THE QUARTER ENDED SEPTEMBER 30, 2017

INDEX

PART I . FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

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

	Unaudited September 30, 2017	December 31, 2016
Assets		
Current assets:		
Deposits on hand	$ 1,481,370	$ 1,501,650
Operating cash	298,003	392,725
Receivables	41,781	39,344
Study and interconnection receivables	9,863	16,077
Prepaid expenses and other current assets	9,425	8,541
Prepaid income taxes	1,122	1,414
Deferred FERC fees	518	2,073
Note receivable	1,892	2,535
	1,843,974	1,964,359
Non-current assets:		
Fixed assets, net of accumulated depreciation and amortization of $617,742 and $585,189	111,635	110,867
Land	1,420	1,420
Projects in development	27,505	32,447
Deferred recovery of pension and postretirement costs	14,887	15,045
Deferred income taxes, net of valuation allowance	51,275	46,065
Note receivable	931	2,373
Other	22,246	19,298
	229,899	227,515
Total assets	$ 2,073,873	$ 2,191,874
Liabilities, paid in capital, retained earnings and accumulated other comprehensive income		
Current liabilities:		
Accounts payable and accrued expenses	$ 14,305	$ 30,430
Due to members	349,227	438,305
Study and interconnection payables	9,935	16,017
Accrued payroll and benefits	23,633	26,405
Current portion of long-term debt	1,317	1,317
Current portion of capital lease	1,612	1,556
Deferred regulatory liability	12,784	4,332
Deferred revenue	875	3,218
Postretirement healthcare benefits liability	1,251	1,157
Other employee benefits	190	109
Deposits	1,481,370	1,501,650
	1,896,499	2,024,496
Non-current liabilities:		
Long-term debt	19,758	20,746
Long-term capital lease	17,189	18,406
Deferred regulatory liability	17,985	4,971
Interest rate swap	793	1,020
Pension benefits liability	39,212	45,107
Postretirement healthcare benefits liability	48,851	47,432
Other employee benefits	24,984	21,598
	168,772	159,280
Total liabilities	2,065,271	2,183,776
Paid in capital	722	722
Retained earnings	7,248	6,834
Accumulated other comprehensive income	632	542
Total paid in capital, retained earnings and accumulated other comprehensive income	8,602	8,098
Total liabilities, paid in capital, retained earnings and accumulated other comprehensive income	$ 2,073,873	$ 2,191,874

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 September 30,		Nine Months ended September 30,	
	2017	2016	2017	2016
Income				
Operating revenues:				
Service fees	$ 80,807	$ 75,855	$ 232,796	$ 210,496
Deferred regulatory expense	(13,016)	(7,342)	(25,322)	(3,882)
FERC fees reimbursement	16,447	16,082	46,268	43,206
Study and interconnection fees	915	834	2,909	2,625
Membership fees	871	858	2,587	2,522
Other	706	691	1,900	1,909
Total operating revenue	86,730	86,978	261,138	256,876
Operating expenses:				
Compensation	32,723	32,426	99,441	95,701
FERC fees	16,447	16,082	46,268	43,206
Depreciation and amortization expense	11,192	13,256	33,874	39,297
Outside services	13,354	12,756	41,580	38,249
Software licenses and fees	3,410	4,395	11,678	12,201
Other expenses	2,547	1,943	7,720	9,224
Pension benefits	2,054	2,958	6,468	7,647
Computer maintenance and office supplies	2,455	1,343	6,413	4,949
Study and interconnection services	915	834	2,909	2,625
Lease expenses	529	368	1,627	1,073
Postretirement healthcare benefits	335	409	1,049	961
Total operating expenses	86,961	86,770	259,027	255,133
Operating income	769	208	2,111	1,743
Other income (expense):				
Interest income	1,476	793	3,733	2,155
Interest expense	1,593	828	4,007	3,397
Total other income (expense)	(117)	(35)	(274)	(1,242)
Income before income taxes	652	173	1,837	501
Income tax expense	493	167	1,423	493
Net income	$ 159	$ 6	$ 414	$ 8
Paid in capital, retained earnings and accumulated other comprehensive income				
Beginning balance	$ 8,422	$ 8,058	$ 8,098	$ 8,056
Net income	159	6	414	8
Other comprehensive income	21	-	90	-
Ending balance	$ 8,602	$ 8,064	$ 8,602	$ 8,064

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) Nine months ended September 30,	
	2017	**2016**
Cash flows from operating activities:		
Net income	$ 414	$ 8
Adjustments:		
Depreciation and amortization expense	33,874	39,297
Deferred income taxes, net of valuation allowance	(5,210)	(2,616)
Deferred recovery of pension and postretirement costs	158	(2,228)
Deferred regulatory liability	25,321	3.962
Employee benefit expense greater than funding	(915)	504
Net fair value changes related to interest rate swap	(227)	368
Changes in assets and liabilities:		
Increase in receivables	(2,437)	(2,250)
Decrease in interconnection receivables	6,214	7,528
(Increase) in prepaid expenses and other	(4,903)	(2,327)
Decrease (increase) in prepaid income taxes	292	(1,336)
Decrease in deferred FERC fees	1,555	-
(Decrease) in accounts payable and accrued expenses	(17,374)	(10,958)
(Decrease) in study and interconnection payables	(6,082)	(9,685)
(Decrease) in accrued payroll and benefits	(2,772)	(2,582)
(Decrease) in deferred FERC fee liability	-	(1,969)
(Decrease) in deferred revenue	(2,343)	(2,366)
Refunds to members	(3,855)	-
Net cash provided by operating activities	21,710	13,350
Cash flows used in investing activities:		
Cost of projects in development	(28,451)	(19,732)
Payments on note receivable	2,085	751
Net cash used in investing activities	(26,366)	(18,981)
Cash flows (used in) from financing activities:		
Repayments under long-term debt	(988)	(12,526)
Borrowings under line of credit	403,207	332,054
Repayments under line of credit	(403,207)	(332,054)
(Decrease) increase in deposits on hand	(20,280)	363,560
(Decrease) in net due to members	(89,078)	160,270
Net cash (used in) provided by financing activities	(110,346)	511,304
Net (decrease) increase in cash and cash equivalents	(115,002)	505,673
Cash and cash equivalents balance, beginning of period	1,894,375	1,314,620
Cash and cash equivalents balance, end of period	$ 1,779,373	$ 1,820,293
Noncash Activity:		
Changes in projects in development additions included in ending Accounts Payable and Accrued Expenses	$ 1,249	$ 806

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 September 30, 2017 and for the three-month and nine-month periods ended September 30, 2017 and September 30, 2016 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 2016 consolidated financial statements and footnotes.

PJM has performed an evaluation of subsequent events through November 8, 2017, 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

Pension and Other Postretirement Benefits

In March 2017, the Financial Accounting Standards Board amended its authoritative guidance on the presentation of net periodic pension and postretirement benefit cost. The guidance requires the service cost component of net periodic benefit cost to be presented separately from the other components of net periodic benefit cost in the Statement of Income, Comprehensive Income and Paid in Capital, Retained Earnings and Accumulated Other Comprehensive Income. The guidance also provides that only the service cost component of pension and other postretirement benefit cost is eligible for capitalization. The guidance is effective for annual periods beginning after December 15, 2018 and interim reporting periods beginning after December 15, 2019, with early adoption permitted. Adoption of the requirements of this guidance is not expected to materially affect the Company's Statement of Financial Position, Consolidated Statement of Income, Comprehensive Income and Paid in Capital, Retained Earnings and Accumulated Other Comprehensive Income or the Consolidated Statement of Cash Flow.

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 6 percent of its annual stated rates revenues, except that beginning for 2017 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 provisions 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 2017, PJM made refunds of $3.8 million. There were no refunds made during the first nine months of 2016.

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 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, 2017 and December 31, 2016, the deferred regulatory liability was $30.3 million and $9.3 million, respectively. At September 30, 2017 and December 31, 2016, the current portion of the deferred regulatory liability was $12.3 million and $4.3 million, respectively. The non-current portion of the deferred regulatory liability of $18.0 million and $5.0 million represent the amount of PJM's reserve at September 30, 2017 and December 31, 2016, 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 loan agreement with MA during March 2008. The original loan agreement was extended in March 2014 to March 31, 2020.

The purpose of the PJM 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 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 September 30, 2017 and December 31, 2016, the interest rate on the loan agreement between PJM and MA was 4.25 and 3.75 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, 2017 and December 31, 2016, the outstanding balance due from MA recorded by PJM as a note receivable was $2.8 million and $4.9 million, respectively. At September 30, 2017 and December 31, 2016, the current portion of the note receivable was $1.9 million and $2.5 million, respectively. The current balance at September 30, 2017, represents the amount to be repaid in the next twelve months. The non-current portion of the note receivable was $0.9 million and $2.4 at September 30, 2017 and December 31, 2016, 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 on March 23, 2018, and can be extended automatically through March 23, 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, 2017. At September 30, 2017 and December 31, 2016, 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, 2017 and December 31, 2016, the interest rate was 1.982 percent and 1.521 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, the 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 Advanced Control Center (AC^2) property. The closing on this facility occurred on April 30, 2009.

On August 22, 2013, the 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.

On March 24, 2016 PJM and PNC amended the loan agreement to reduce the spread over LIBOR from 110 basis points to 75 basis points. The commitment amount of the loan and maturity date were not changed.

As of September 30, 2017 and December 31, 2016, outstanding borrowings under this loan were $21.1 million and $22.1 million, respectively. As defined in the loan agreement, the interest rate is based on the LIBOR in effect at each reset date plus a spread of 75 basis points. The reset date is monthly. As of September 30, 2017 and December 31, 2016, the interest rate was 1.982 percent and 1.367 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 September 30, 2017.

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 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 fixes the interest payments on the Company's floating rate debt instrument at a rate of 2.85 percent plus the spread over LIBOR through September 1, 2021, which resulted in a fixed interest rate of 3.95 percent. 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 matches the term of the loan.

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, 2017 and December 31, 2016, the fair value of the swap was a liability of $0.8 million and $1.0 million, respectively.

The amount of the derivative gains (losses) 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, 2017	**September 30, 2016**
Unrealized mark-to-market gains (losses)	$ 95	$ 459
Total net mark-to-market gains (losses)	$ 95	$ 459

	Nine months ended	
	September 30, 2017	**September 30, 2016**
Unrealized mark-to-market gains (losses)	$ 227	$ (368)
Total net mark-to-market gains (losses)	$ 227	$ (368)

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

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 September 30, 2017, was $608 million. A total of 232 members were FTR holders related to a total of 2,461,340 megawatt hours. As of September 30, 2017, PJM held $1,548.9 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, 2017:

$ in millions

Balance at July 1, 2017	$	804
Auction additions		17
Settlement and change in fair value		(213)
Balance at September 30, 2017	$	608

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, 2017 and December 31, 2016 by level within the fair value hierarchy.

$ in millions

	September 30, 2017				December 31, 2016
	Level 1	**Level 2**	**Level 3**	**Carrying Value**	**Carrying Value**
Cash and cash equivalents	$ 1,779	$ -	$ -	$ 1,779	$ 1,894
Deposit liabilities	1,481	-	-	1,481	1,502
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 Employee Benefits	
Components of Net Periodic Benefit Cost for the period July 1 to September 30	**Qualified**		**SERP***			
	2017	**2016**	**2017**	**2016**	**2017**	**2016**
Service cost	$ 2,133	$ 2,029	$ 89	$ 113	$ 384	$ 357
Interest cost	2,114	1,981	76	95	592	607
Settlement charge	-	-	-	842	-	-
Expected return on assets	(2,621)	(2,450)	-	-	(116)	(78)
Prior service cost	(5)	(5)	2	2	(322)	(322)
Actuarial loss	256	314	99	124	(113)	(65)
Total net periodic benefit cost	$ 1,877	$ 1,869	$ 266	$ 1,176	$ 425	$ 499

**Supplemental Executive Retirement Plan*

For each the of three month periods ended September 30, 2017 and September 30, 2016, $0.2 million of total pension and postretirement benefits costs were included in capitalized project costs, respectively.

	Pension Benefits				Other Postretirement Employee Benefits	
Components of Net Periodic Benefit Cost for the period January 1 to September 30	**Qualified**		**SERP***			
	2017	**2016**	**2017**	**2016**	**2017**	**2016**
Service cost	$ 6,900	$ 6,736	$ 211	$ 205	$ 1,157	$ 1,105
Interest cost	6,431	6,034	180	185	1,799	1,712
Settlement charge	-	-	-	842	-	-
Expected return on assets	(7,951)	(7,257)	-	-	(348)	(233)
Prior service cost	(14)	(14)	5	5	(965)	(965)
Actuarial loss	843	1,049	165	143	(291)	(375)
Total net periodic benefit cost	$ 6,209	$ 6,548	$ 561	$ 1,380	$ 1,352	$ 1,244

For each the of nine month periods ended September 30, 2017 and September 30, 2016, $0.6 million and $0.5 million of total pension and postretirement benefits costs were included in capitalized project costs, respectively.

Assumptions used to determine net periodic benefit cost as of September 30	**Pension Benefits**		**Postretirement**	
	2017	**2016**	**2017**	**2016**
Discount rate	4.40%	4.50%	4.40%	4.50%
Expected return on plan assets	6.75%	7.00%	6.75%	7.00%
Rate of compensation increase	4.50%	4.50%	N/A	N/A
Medical care cost trend rate				
Current (Pre-65)			6.42%	6.66%
Current (Post-65)			7.37%	7.78%
Ultimate (Pre-65)			4.46%	4.46%
Ultimate (Post-65)			4.45%	4.45%
Years to ultimate			21	22

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,	
	2017	**2016**
Income tax expense at the federal statutory rate	$ 643	$ 170
Increase (decrease) resulting from:		
Change in valuation allowance	259	-
Permanent items	303	298
State income taxes, net of federal tax benefit	184	74
Other	34	(49)
Income tax expense	$ 1,423	$ 493

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 2013 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 Re-allocation

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 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 million.

Several parties affected by the Commission's underlying ruling in this matter sought judicial review of the FERC's decision in the DC Circuit Court of Appeals, and, in the ruling issued in August, 2013, the Court of Appeals directed 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. Collection actions referenced above remain stayed in the Delaware courts, and PJM is considering its options in light of the FERC's November 2015 order. 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 (Original Complaint) against PJM with the FERC. In the Original Complaint, TranSource asks 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 Original Complaint for investigation and a trial-type evidentiary hearing on all issues raised in the docket. The FERC encouraged the parties to settle their disputes, held the hearing in abeyance and directed appointment of a settlement judge. As directed by FERC, PJM, TranSource and the affected PJM transmission owners (which had intervened in the case) engaged in extensive settlement discussions with the assistance of the assigned settlement judge. On February 10, 2016, while in settlement discussions, TranSource filed an amended and restated 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. PJM believes the claim for monetary damages in the Amended Complaint is speculative and is 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. On March 1, 2016, 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 hearings 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 in October 2017 with reply briefs due by the end of November 2017. An initial decision is anticipated in mid-January 2018. PJM does not believe that this matter will have a material adverse effect on its financial position.

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 $5.0 million, or 7 percent, to $80.8 million for the three months ended September 30, 2017 compared with the three months ended September 30, 2016; and increased $22.3 million, or 11 percent, to $232.8 million for the nine months ended September 30, 2017 compared with the nine months ended September 30, 2016. The variance in service fees is principally due to the implementation of new stated rate tariff rates on January 1, 2017. Transmission volume for the three and nine month periods ended September 30, 2017 were 217 terawatt hours (TWhs) and 609 TWhs as compared with 237 TWhs and 633 TWhs for the three and nine month periods ended September 30, 2016.

Total expenses, excluding FERC fees, study and interconnection services, interest expense and income taxes, decreased $0.8 million, or 1 percent, to $69.1 million for the three month period September 30, 2017 as compared with the three month period ended September 30, 2016; and increased $1.0 million, to $210.4 million for the nine months ended September 30, 2017 as compared with the nine months ended September 30, 2016. For the nine month period ended September 30, 2017, the increases in compensation expense and outside services were partially offset by decreases in depreciation and amortization expense due to Advanced Second Control Center assets being fully depreciated and pension and other expenses.

Liquidity and Capital Resources

PJM has a revolving credit agreement with PNC Bank (PNC) for $100 million, which expires on March 23, 2018, and can be extended automatically through March 23, 2021. At September 30, 2017, there were no outstanding borrowings 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 September 30, 2017 the outstanding borrowings under the amended loan were $21.1 million.

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 months ended September 30, 2017, approximately sixty percent of PJM's service fees were billed to approximately thirty nine of its members, each of which has an investment-grade credit rating according to at least one of three major rating services or has 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 Re-allocation*</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 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 million.

Several parties affected by the Commission's underlying ruling in this matter sought judicial review of the FERC's decision in the DC Circuit Court of Appeals, and, in the ruling issued in August, 2013, the Court of Appeals directed 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. Collection actions referenced above remain stayed in the Delaware courts, and PJM is considering its options in light of the FERC's November 2015 order. 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.

<u>*TranSource Matter*</u>

On June 23, 2015, TranSource, LLC (TranSource) filed a complaint (Original Complaint) against PJM with the FERC. In the Original Complaint, TranSource asks 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 Original Complaint for investigation and a trial-type evidentiary hearing on all issues raised in the docket. The FERC encouraged the parties to settle their disputes, held the hearing in abeyance and directed appointment of a settlement judge. As directed by FERC, PJM, TranSource and the affected PJM transmission owners (which had intervened in the case) engaged in extensive settlement discussions with the assistance of the assigned settlement judge. On February 10, 2016, while in settlement discussions, TranSource filed an amended and restated 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. PJM believes the claim for monetary damages in the Amended Complaint is speculative and is 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. On March 1, 2016, 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 May 10, 2016, the Commission issued an order establishing hearing procedures finding that the issues addressed in the Amended Complaint should allow persons not currently parties to the proceeding an opportunity to intervene. A prehearing conference was held on August 2, 2016. Based on a revised procedural schedule, TranSource filed its direct testimony on January 4, 2017, consistent with its allegations raised in the FERC docket. Answering testimony by PJM and the Interconnected Transmission Owners was filed on March 29, 2017. On June 6, 2017, PJM and the PJM Market Monitor filed a partial settlement agreeing on a detailed description of the IARR process and methods PJM employs to address IARR requests under section 7.8 of Schedule 1 of the PJM Operating Agreement. Trial Staff's Answering Testimony was filed on June 8, 2017. PJM submitted prepared cross-answering testimony and exhibits on June 30, 2017. On July 31, 2017, as corrected on August 11, 2017, TranSource submitted prepared rebuttal testimony and exhibits.

On August 30, 2017, TranSource submitted a motion accepted by the Presiding Judge permitting a TranSource witness to testify at hearings 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 in October 2017 with reply briefs due by the end of November 2017. An initial decision is anticipated in mid-January 2018. PJM does not believe that this matter will have a material adverse effect on its financial position.