PJM 2015 Financial Report

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MANAGEMENT'S DISCUSSION AND ANALYSIS

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; actuarial assumptions; availability of credit; liquidity; general economic conditions; changes in accounting principles and practices; acts of terrorists; the actions of adjacent control areas and other Regional Transmission Organizations (RTOs); 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 the 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.

NATURE OF OPERATIONS

The Company currently coordinates a pooled generating capacity of more than 185,000 megawatts and operates wholesale electricity markets with more than 950 members. PJM enables the delivery of electric power to more than 61 million people in all or parts of Delaware, Illinois, Indiana, Kentucky, Maryland, Michigan, New Jersey, North Carolina, Ohio, Pennsylvania, Tennessee, Virginia, West Virginia and the District of Columbia.

PJM manages a sophisticated regional planning process for generation and transmission expansion to ensure continued reliability of the electric system. Using information technology, PJM provides real-time information to market participants to support their daily transactions and business decision-making. In addition to ensuring the reliable supply of electricity, PJM administers Internet-based bid markets in which participants buy and sell day-ahead and spot market energy, financial transmission rights, synchronized reserves and regulation services.

PJM Settlement, Inc. (PJM Settlement) is a wholly owned subsidiary of PJM, organized as a Pennsylvania nonprofit corporation, and is a FERC-regulated entity. PJM Settlement was formed to handle all of the credit, billing and settlement functions for PJM's members' transactions in the PJM markets and for transmission service. PJM Settlement acts as a counterparty to members' pool transactions in the PJM markets. For the pool transactions in the PJM markets, flash title passes through PJM Settlement immediately prior to passing to the ultimate buyer and seller of the product. This arrangement reinforces PJM's authority to continue to net a member's offsetting financial positions in the PJM markets for credit and billing purposes; provides clarity in PJM Settlement's legal standing to pursue collection from a bankrupt member; and also complies with the FERC recommendation on credit policy requirements for competitive wholesale electricity markets.

PJM Technologies, Inc. (PJM Tech) is a wholly owned subsidiary of PJM and is not a FERC-regulated entity. PJM Tech was formed to provide service and technology solutions pioneered by PJM to existing and emerging energy markets, system operators and RTOs.

PJM Environmental Information Services, Inc. (PJM EIS) is a wholly owned subsidiary of PJM Tech formed to provide environmental and emissions attributes reporting and tracking services to its subscribers in support of renewable portfolio standards and other disclosure requirements that may be implemented by governmental agencies. PJM EIS is not a FERC-regulated entity.

TARIFF COST RECOVERY

PJM recovers its administrative costs through three elements under the Open Access Transmission Tariff (Tariff).

The first element is a composite rate. Beginning October 1, 2011, the composite rate was 29 cents per megawatt-hour (MWh).

The second element is a rider for the Advanced Second Control Center (AC^2). The Tariff establishes a specific mechanism for PJM to collect from its members the actual costs to construct and operate AC^2. The recovery of those costs is from a formula rate set forth in a separate schedule in the Tariff. The recovery is capped at the capitalized investment costs and operating costs of AC^2. PJM began to recover costs under this rider in July 2008. The rider is scheduled to expire seven years from November 2011, which was the in-service date of the AC^2 energy management system. During 2015, 2014 and 2013, $22.6 million, $27.8 million and $28.0 million were billed under this rider, respectively.

The third element provides for accumulation of a financial reserve up to 6 percent of annual revenues and subsequent refunds to PJM's members, if applicable.

PJM Settlement recovers its administrative costs under a separate schedule under the Tariff.

PJM has the right to file with the FERC for prospective changes to these rates at any time, if necessary.

SIGNIFICANT ACCOUNTING POLICIES

Preparation of the financial statements and related disclosures in compliance with generally accepted accounting principles requires the application of appropriate technical accounting rules and guidance, as well as the use of estimates. PJM's application of those principles involves judgments regarding many factors, which, in and of themselves, could materially affect the financial statements and disclosures. A future change in the assumptions or judgments applied in determining the following matters, among others, could have a material impact on future financial results: revenue recognition, net presentation of member activity, accounting for deferred recovery of pension and postretirement costs, accounting for deferred regulatory liability, benefit plan accounting, fixed asset capitalization, income tax accounting and study and interconnection activity.

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 (FTRs), revenue and expense, on a net basis in its consolidated financial statements.

Deferred Recovery of Pension and Postretirement Costs

The Company recognizes the funding status of the projected benefit obligation (PBO) of its defined benefit pension plan as a liability in the Consolidated Statement of Financial Position. The PBO represents the actuarial present value of benefits attributable to employee service rendered to date, including the effects of estimated future salary increases. At December 31, 2015, in addition to recording the underfunded PBO as a liability, PJM recorded a regulatory asset to reflect the anticipated future recovery of the amounts expected to be funded in the future through the Company's rate structure. This regulatory asset, which will be amortized each quarter as the net periodic benefit cost of the underfunded liability is recognized, was $11.9 million and $21.8 million at December 31, 2015 and 2014, respectively.

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 service fee revenues, less the revenue collected under the AC^2 rider and the PJM Settlement rate schedule, except that beginning 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. On a quarterly basis, PJM refunds the deferred regulatory liability balance in excess of 6 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. For calendar years 2015, 2014 and 2013, PJM made refunds of $0.3 million, $23.9 million and $21.2 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 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 December 31, 2015 and 2014, the deferred regulatory liability was $7.2 million and $11.4 million, respectively. In both periods, the balance was classified as non-current and represents PJM's reserve.

Benefit Plan Accounting

PJM accrues the costs of providing future employee benefits in accordance with the guidance of Employers' Accounting for Pensions and Postretirement Benefits Other than Pensions (ASC 715). Under this guidance, assumptions are made regarding the valuation of benefit obligations and performance of plan assets. Delayed recognition of differences between actual results and those assumed is a guiding principle of these standards. This approach allows for a relatively even recognition of the effects of changes in benefit obligations and plan performance over the working lives of the employees who benefit under the plans.

In addition to recognizing the underfunded PBO of a defined benefit pension plan as an asset or liability in the Consolidated Statement of Financial Position, PJM recognizes annual changes in gains or losses, prior service costs or other credits that have otherwise not been recognized as a part of the liability for pension benefits in the Consolidated Statement of Financial Position. A corresponding regulatory asset, deferred pension and postretirement costs, has been recognized in the Consolidated Statement of Financial Position.

PJM's selection of the discount rate, healthcare cost trend rate and expected rate of return on pension assets is based on its review of available current, historical and projected rates, as applicable.

In selecting the discount rate assumption for the PJM retirement plan at December 31, 2015, the Company used a method that matches projected payouts from the plan with a yield curve that was produced from a universe containing over 500 U.S.-issued Aa-rated corporate bonds, all of which were noncallable (or callable with make-whole provisions), and excluding the 10 percent of the bonds with the highest yields and the 10 percent with the lowest yields. The discount rate was then developed as a level equivalent rate that would produce the same present value as would result using spot rates to discount the projected pension benefit payments. Based on this analysis, the discount rate for its pension plan and postretirement healthcare plan increased to 4.50 percent at December 31, 2015. The results during 2015 were derived using a discount rate of 4.10 percent.

In selecting an expected return on plan assets, PJM considers past performance and economic forecasts for the types of investments held by the plans. The assumption for the expected rate of return on assets remained at 7.00 percent during 2015 and at December 31, 2015. The assumption for the expected rate for which compensation will increase remained at 4.50 percent at December 31, 2015. In selecting healthcare cost trend rates, PJM considers past performance and forecasts of healthcare costs. The rate selected at December 31, 2014, was 7.20 percent, declining to 4.50 percent over the next 14 years.

Changes in the assumptions listed above could have a significant impact on the accrued pension and other postretirement benefit liabilities and reported annual net periodic pension and other postretirement benefit costs. For example, the effect of a 1.00 percent increase in the assumed healthcare cost trend rate from 7.20 percent to 8.20 percent would increase the postretirement benefit obligation as of December 31, 2015, by $3.0 million and the current year postretirement benefit cost by approximately $0.4 million. A 1.00 percent decrease in the assumed healthcare cost trend rate from 7.20 percent to 6.20 percent would decrease the accumulated postretirement benefit obligation by approximately $5.4 million and would decrease the postretirement benefit cost by approximately $0.4 million annually.

During 2015, PJM expensed net periodic pension and other postretirement benefit costs of $11.5 million. This amount represents a $4.3 million increase in expense compared with the amount recognized during 2014. The 2014 to 2015 increase in expenses related to pension and postretirement healthcare benefits is primarily attributable to a decrease in the discount rate for the related liabilities effective December 31, 2014.

Fixed Asset Capitalization

PJM's fixed assets are comprised principally of software and capitalized software development costs, leasehold improvements, computer hardware and buildings. The costs incurred to acquire and develop computer software for internal use, including financing costs, are capitalized. However, costs incurred prior to the determination of feasibility of developed software and costs incurred following the in-service date of developed software are expensed. Fixed assets are depreciated or amortized using the straight-line method over the useful lives of the assets as follows:

Software and capitalized software developments costs	3 to 10 years
Computer hardware	3 to 5 years
Leasehold improvements	10 to 15 years
Furniture and fixtures	10 years
Buildings	25 years
Vehicles	5 years

Income Tax Accounting

PJM has elected to be taxed as a corporation for both federal and state income tax purposes. PJM and its subsidiaries file a consolidated federal income tax return. The consolidated financial statements include prepaid income taxes, accrued income taxes and deferred income taxes. Prepaid income taxes relate to federal and state overpayments on deposit with taxing authorities. These overpayments will be applied to future federal and state income tax liabilities. Deferred income tax assets represent the temporary differences between the Company's financial statement basis and tax basis in existing assets and liabilities measured using presently enacted tax rates. A valuation allowance has been provided against certain deferred tax assets in which management has concluded it is more likely than not the Company will be unable to recognize the income tax benefit associated with those future tax deductions.

Study and Interconnection Activity

Under the Tariff, PJM's transmission provider role is to direct the operation and coordinate the maintenance of the transmission system and indicate, based on studies conducted by PJM, necessary enhancements or modifications to the transmission system. The modifications that are performed on the transmission system, such as network upgrades and generation additions, are conducted principally by third-party vendors at the request of transmission customers. In its system-planning capacity as transmission service provider, PJM provides billing and collection services in the interconnection service agreement process. Billings and collections by PJM for work it performs on behalf of the counterparties to the specific interconnection agreements are reported on a net basis in the Consolidated Statement of Income, Comprehensive Income and Paid in Capital, Retained Earnings and Accumulated Other Comprehensive Income.

RESULTS OF OPERATIONS FOR 2015, 2014, 2013

REVENUES

PJM's service fees decreased $19.5 million, or 7 percent, to $268.7 million from 2014 to 2015. The decrease is attributable to lower member transaction volumes during 2015, primarily due to several months of unseasonably mild weather. Transmission volumes for 2015 were 822 terawatt hours (TWhs) as compared with 838 TWhs for 2014.

PJM's service fees increased $5.3 million, or 2 percent, to $288.2 million from 2013 to 2014. The increase is attributable to higher member transaction volumes during 2014 and higher bidding activity under the various PJM auctions. Transmission volumes for 2014 were 838 TWhs as compared with 834 TWhs for 2013.

Deferred regulatory income represents PJM's stated rate tariff service fees in excess of expenses and is reported as an offset to total revenues. The deferred regulatory income decreased $24.7 million, or 119 percent, from 2014 to 2015. For the year ended December 31, 2015, PJM's expenses exceeded service fee revenues due to lower than anticipated revenues during mild weather, which caused PJM to reflect a deferred regulatory expense.

Net income is derived from PJM's non-FERC regulated subsidiaries, primarily from PJM EIS activity. Net income was $1.0 million, $0.9 million and $1.0 million, for each of the years ended December 31, 2015, 2014 and 2013, respectively.

EXPENSES

Total expenses, excluding FERC fees, study and interconnection services, interest expense and income taxes, increased $6.3 million to $275.3 million in 2015 as compared with an increase of $0.4 million in 2014. The increases in expenses in 2015 resulted primarily from the following factors: (1) a $5.3 million increase in compensation expense due to annual merit increases; (2) a $4.3 million increase in pension and postretirement expense primarily due to the effect of the decrease in the discount rate used to measure the associated liabilities effective December 31, 2014; and, (3) a $2.1 million increase in other expenses due to the estimated cost of Monitoring Analytics' planned withdrawal from PJM's pension plan. Those increases in expenses were partially offset by: (1) a $3.2 million reduction in depreciation and amortization expense as portions of the AC^2 capital investment completed recovery; and, (2) a $3.4 million reduction in usage of outside services.

Total expenses, excluding FERC fees, study and interconnection services, interest expense and income taxes, increased $0.4 million to $269.1 million in 2014, as compared with an increase of $7.6 million, or 3 percent, in 2013. The increases in compensation expense, software maintenance and licenses and the cost of outside services were offset by a decrease of $7.2 million in expenses associated with pension and postretirement healthcare benefits. The $4.6 million increase in compensation expense is primarily the result of normal cost-of-living adjustments. The $2.6 million increase in outside services is principally attributable to consulting expenses for various projects. The $1.4 million increase in software maintenance and licenses is primarily due to inflation and a larger software base to support. The decrease in expenses related to pension and postretirement healthcare benefits is primarily attributable to an increase in the discount rate for the related liabilities effective December 31, 2013.

For the years ended December 31, 2015, 2014 and 2013, outside services included amounts paid to PJM's independent auditor, PricewaterhouseCoopers LLP, totaling $1.1 million, $1.1 million and $1.4 million, respectively, which were predominantly for audits of the PJM Consolidated Financial Statements and examination of certain internal controls related to PJM's market settlements and associated information technology systems and processes.

Key information systems, system enhancements and capital investments completed by PJM in 2015 include:

- *Market System Enhancements*, enhancing market coordination, demand response and day-ahead and retail market software;
- *Operations and Planning-System Enhancements*, enhancing Operations and Planning applications including Energy Management System, Black Start, visual displays for operators and training applications;
- *Technology Infrastructure*, upgrading servers, storage, networks and telecommunications equipment to ensure compliance and reliability;
- *Legacy Portfolio Migration and Modernization*, ensuring all legacy applications are consistent with technology adopted during AC^2;
- *Identity Management*, improving the reliability and efficiency of PJM's processes for authorization and providing access to information technology systems, as well as ensuring compliance with North American Electric Reliability Corporation (NERC) Critical Infrastructure Protection (CIP) standards; and
- *Cybersecurity*, hardware and software upgrades to ensure compliance and security of PJM's systems.

BILLINGS FOR SERVICES

Membership increased to approximately 950 members at December 31, 2015, as compared with approximately 940 members at December 31, 2014. The billings presented below are administered on behalf of the members; however, the associated receivables and payables are presented net in PJM's Consolidated Statement of Income, Comprehensive Income and Paid in Capital, Retained Earnings and Accumulated Other Comprehensive Income. The only billings included in PJM's consolidated financial statements are PJM Scheduling, System Control and Dispatch, AC[2] Costs, PJM Settlement and the FERC annual Recovery Charge. For 2015, 2014 and 2013, settlements processed by PJM under the Tariff, Operating Agreement and Reliability Assurance Agreement, which is a non-GAAP measure, were as follows:

(in millions)	2015 Amount Billed	2014 Amount Billed	2013 Amount Billed
Energy Markets	$ 23,064	$ 30,573	$ 19,333
Capacity	9,527	7,735	6,102
Network Transmission Service	3,681	3,162	2,704
Transmission Congestion	1,367	2,572	1,033
Transmission Enhancement	1,245	961	763
FTR Auction Revenues	1,182	960	792
Transmission Losses (Point-to-Point)	1,056	1,677	1,035
Operating Reserves	292	918	426
Reactive Supply	278	280	276
PJM Scheduling, System Control and Dispatch (Operating Expense Reimbursement, net of stated rate refunds)	247	237	234
Regulation Market	180	258	189
Day-Ahead Scheduling Reserve Market	77	36	44
Point-to-Point Transmission Service	77	79	68
RTO Scheduling, System Control and Dispatch (Transmission Owners' Control Center Expenses)	70	69	64
FERC Annual Charge Recovery	55	59	49
Black Start Service	54	60	116
Distribution Facilities	34	21	22
Spinning Reserve Market	31	175	36
Advanced Second Control Center Costs	23	28	28
ReliabilityFirst Corporation (RFC)	14	12	11
MISO Transmission Expansion Planning (MTEP) Cost Recovery	11	14	2
Reactive Services	11	1	364
Load Response Program	9	61	58
North American Electric Reliability Corporation (NERC)	9	8	8
PJM Settlement	8	9	8
Generation Deactivation	7	27	52
Market Monitoring Unit Funding	7	9	9
Expansion Cost Recovery and RTO Start-up Cost Recovery	4	8	9
Ramapo PAR (Phase Angle Regulator) Facilities	4	2	2
Inadvertent Interchange	3	4	7
Miscellaneous	3	7	3
Michigan-Ontario Interface Phase Angle Regulators	2	2	2
Organization of PJM States, Inc. (OPSI) Fees	1	1	1
Customer Default Allocation Assessments, net of recoveries	1	-	13
Emergency Energy	-	5	-
Total	**$ 42,634**	**$ 50,030**	**$ 33,863**

LIQUIDITY AND CAPITAL RESOURCES

Under the stated rate tariff, PJM collects 29 cents per MWh. This rate was in effect for 2015 and will be in effect for 2016. At the end of 2015, the accumulated financial reserve was $7.2 million. PJM is projecting this accumulated financial reserve balance to be unchanged at December 31, 2016.

During 2016, PJM will be engaging the Finance Committee to discuss future rate levels.

In the event PJM's actual expenses are projected to exceed its revenues and financial reserve, PJM is empowered to and would need to file a rate case with the FERC.

PJM has a revolving credit agreement with PNC Bank (PNC) for $100 million, which expires on March 30, 2016. The facility is unsecured and is available to fund short-term cash obligations. At December 31, 2015, there were no outstanding borrowings under the revolving credit agreement. On December 23, 2015, PJM filed with the FERC, requesting approval to continue to borrow under this facility. PJM received this approval on February 16, 2016. PJM will be executing this renewal with PNC during the first quarter of 2016.

On March 31, 2009, the FERC approved PJM's application to enter into a $35 million loan agreement with PNC. On August 23, 2013, the FERC approved PJM's application to amend and refinance at a lower interest rate than 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 December 31, 2015, the outstanding borrowings under the amended loan were $23.4 million. PJM is expected to make $1.3 million of principal payments during 2016.

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 under this facility. At December 31, 2015, outstanding borrowings were $11.5 million. The purpose of this borrowing was to fund the technology investment in AC^2. These notes mature on September 15, 2016.

Under the loan covenants for each facility, PJM is required to provide unaudited financial statements 45 days after each quarter and audited financial statements 120 days after year-end. PJM is in compliance with these covenants.

As of December 31, 2015 and 2014, PJM and PJM Settlement were assigned Aa3 issuer ratings by Moody's Investors Service.

For study and interconnection work performed, PJM obtains liquid collateral from the transmission customer for the estimated costs of the transmission system modifications. PJM's study and interconnection receivables are comprised of billings to transmission customers for services performed under these interconnection service agreements. PJM's study and interconnection payables represent amounts due to the transmission owners for services performed under these interconnection service agreements. PJM held deposits related to study and interconnection activity totaling $83.4 million and $62.3 million at December 31, 2015 and 2014, respectively.

PJM Settlement requires deposits from various parties in connection with services to be performed or as collateral for market activity. PJM Settlement held credit deposits of $1,059.4 million and $1,025.5 million at December 31, 2015 and 2014, respectively. These deposits are maintained in separate cash accounts that are not legally restricted. At December 31, 2015, PJM Settlement also held approximately $1.4 billion in letters of credit as collateral for market activity.

For 2016, PJM's Board of Managers has approved a capital budget of $36 million. These capital expenditures will be used for application replacements, system reliability applications, new products and services for PJM's membership, risk management and interregional coordination. Actual expenditures may differ from these amounts as PJM continues to assess its capital needs.

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.

Contingencies and Recent Regulatory Actions

Third-Party Relationships

PJM engages third parties as suppliers in arrangements to provide services in areas other than core competencies to ensure the service and support of members and timely product development. Although PJM seeks to establish strong working relationships with parties who share PJM's industry goals and have adequate resources to fulfill their responsibilities, these relationships lead to a number of risks. These suppliers may suffer financial or operational difficulties that may affect their performance, which could lead to delays in product development or timely completion of projects. Also, major companies from which PJM purchases components or services may be competitors in other areas, which could affect pricing, new product development or future performance. Finally, difficulties in coordinating activities may lead to gaps in delivery and performance of PJM services.

Credit Risks

PJM bills and collects its operating expenses monthly from its members. Payment of all operating expense bills is due from PJM's members three business days after the month-end bill is issued by PJM, generally within the first two weeks of each month. During 2015, approximately 61 percent of PJM's operating expenses were billed to 21 of its members, each of which either has an investment-grade credit rating according to at least one of the three major rating services or has provided a guaranty from an affiliate with an investment-grade rating. In comparison, during 2014, approximately 65 percent of PJM's operating expenses were billed to 28 of its members. PJM had approximately 950 members at year-end 2015 and approximately 940 members at year-end 2014. In the event of default of any PJM members, PJM has the right to bill the remaining PJM members a ratable portion of the operating expenses previously billed to the defaulting member.

In accordance with the PJM credit policy, PJM obtains collateral from certain members in order 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 to fulfill certain credit requirements.

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 its 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 its 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. To date, PJM has received approximately $16.8 million, or nearly 99%, 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 Reallocation

Between July 17, 2012, and July 20, 2012, 14 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.

Several parties affected by the Commission's underlying ruling in this matter sought judicial review of the FERC's decision in the D.C. Circuit Court of Appeals, 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. 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 ("Complaint") against PJM with the FERC. In the 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 the 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 and 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 it 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 it is not entitled to consequential damages or lost profits from any asserted delay or non-performance by PJM or the associated transmission owner. PJM will seek to dismiss the Amended Complaint with prejudice on procedural and substantive grounds. PJM does not believe that this matter will have a material adverse effect on its financial position.

MANAGEMENT´S RESPONSIBILITY FOR FINANCIAL REPORTING

The management of PJM Interconnection, L.L.C. is responsible for the preparation and objectivity of the following consolidated financial statements and for their integrity. These financial statements have been prepared to conform to accounting principles generally accepted in the United States of America and, where required, include amounts that represent management’s best judgments and estimates. PJM’s management also is responsible for the preparation of other information in this annual report and for its accuracy and consistency with the financial statements.

PJM has established a system of internal accounting and financial controls and procedures designed to provide reasonable assurance as to the integrity and reliability of financial reporting. Management continually reviews the effectiveness and efficiency of this system and takes actions when opportunities for improvement are identified.

This system includes a separate Internal Audit Department, which monitors internal controls and reports directly to the Audit Committee of the Board of Managers. Management views the purpose of internal auditing to be an independent examination and assessment of PJM’s activities related to compliance with policy, procedures and the law, as well as safeguarding of assets. The Audit Committee meets with management, internal auditors and the independent auditors on a regular basis to review financial information, internal controls and the internal audit process.

PJM’s independent auditors, PricewaterhouseCoopers LLP, are engaged to conduct an independent audit of PJM’s consolidated financial statements in accordance with generally accepted auditing standards.

Andrew L. Ott
President and Chief Executive Officer

Suzanne S. Daugherty
Senior Vice President, Chief Financial Officer and Treasurer

INDEPENDENT AUDITOR´S REPORT

To the Board of Managers of PJM Interconnection, L.L.C.:

We have audited the accompanying consolidated financial statements of PJM Interconnection, L.L.C. and its subsidiaries, which comprise the consolidated statements of financial position as of December 31, 2015 and 2014, and the related consolidated statements of income, comprehensive income and paid in capital, retained earnings and accumulated other comprehensive income and of cash flows for the three years then ended.

Management´s Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor´s Responsibility

Our responsibility is to express an opinion on the consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Company's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of PJM Interconnection, L.L.C. and its subsidiaries at December 31, 2015 and 2014, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2015 in accordance with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Philadelphia, Pennsylvania
March 1, 2016

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

($ in thousands)	2015	2014
Assets		
Current assets:		
Deposits on hand	$ 1,142,789	$ 1,087,798
Operating cash	171,831	36,662
Receivables	22,006	31,459
Study and interconnection receivables	21,277	8,667
Prepaid income taxes	45	47
Deferred FERC fees	-	408
Prepaid expenses and other	8,710	9,246
Note receivable	1,704	751
	1,368,362	1,175,038
Non-current assets:		
Fixed assets, net of accumulated depreciation and amortization of $578,200 and $524,503	136,201	162,800
Land	1,420	1,420
Projects in development	23,065	20,040
Deferred recovery of pension and postretirement costs	11,935	21,800
Deferred income taxes, net of valuation allowance	41,371	32,742
Note receivable	2,436	2,463
Other	19,227	15,941
	235,655	257,206
Total assets	$ 1,604,017	$ 1,432,244
Liabilities, paid in capital, retained earnings and accumulated other comprehensive income		
Current liabilities:		
Accounts payable and accrued expenses	$ 22,530	$ 35,636
Due to members	198,205	60,690
Study and interconnection payables	22,710	8,872
Accrued payroll and benefits	25,192	24,810
Current portion of long-term debt	12,852	12,855
Current portion of capital lease	1,483	1,410
Deferred FERC fees	2,626	-
Deferred revenue	3,231	3,293
Postretirement healthcare benefits liability	978	916
Other employee benefits	2,133	640
Deposits	1,142,789	1,087,798
	1,434,729	1,236,920
Non-current liabilities:		
Long-term debt	22,067	34,919
Long-term capital lease	19,962	21,445
Deferred regulatory liability	7,159	11,388
Interest rate swap	1,444	1,479
Pension benefits liability	49,555	54,847
Postretirement healthcare benefits liability	44,193	48,124
Other employee benefits	16,852	16,043
	161,232	188,245
Total liabilities	1,595,961	1,425,165
Commitments and contingencies (Note 13)		
Paid in capital	722	722
Retained earnings	6,744	5,788
Accumulated other comprehensive income	590	569
Total paid in capital, retained earnings and accumulated other comprehensive income	8,056	7,079
Total liabilities, paid in capital, retained earnings and accumulated other comprehensive income	$ 1,604,017	$ 1,432,244

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

CONSOLIDATED STATEMENT OF INCOME, COMPREHENSIVE INCOME AND PAID IN CAPITAL, RETAINED EARNINGS AND ACCUMULATED OTHER COMPREHENSIVE INCOME

($ in thousands)	2015	2014	2013
Income			
Revenue:			
Service fees	$ 268,710	$ 288,174	$ 282,917
Deferred regulatory expense (income)	3,881	(20,849)	(22,367)
FERC fees reimbursement	52,038	55,420	53,907
Study and interconnection fees	3,291	3,250	3,566
Interest income	847	639	444
Membership fees	3,392	3,345	3,165
Other income	2,755	2,460	2,387
Total revenue	334,914	332,439	324,019
Expenses:			
Compensation	124,320	118,985	114,411
Depreciation and amortization	53,940	57,092	55,272
FERC fees	52,038	55,420	53,907
Outside services	49,664	53,033	50,385
Software licenses and fees	15,162	14,422	13,053
Other expenses	12,295	9,060	9,616
Pension benefits	10,289	6,571	10,782
Computer maintenance and office supplies	7,146	7,621	9,435
Study and interconnection services	3,291	3,250	3,566
Interest expense	1,907	2,671	1,918
Lease expenses	1,342	1,745	2,221
Postretirement healthcare benefits	1,170	548	3,509
Total expenses	332,564	330,418	328,075
Income (loss) before income taxes	2,350	2,021	(4,056)
Income tax expense (benefit)	1,394	1,141	(5,010)
Net income	$ 956	$ 880	$ 954
Other comprehensive income:			
Unrealized gain on securities, net	21	178	68
Comprehensive income, net	$ 977	$ 1,058	$ 1,022
Paid in capital, retained earnings and accumulated other comprehensive income			
Beginning balance	$ 7,079	$ 6,021	$ 4,999
Net income	956	880	954
Other comprehensive income	21	178	68
Ending balance	$ 8,056	$ 7,079	$ 6,021

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

CONSOLIDATED STATEMENT OF CASH FLOWS

($ in thousands)	2015	2014	2013
Cash flows from operating activities:			
Net income	$ 956	$ 880	$ 954
Adjustments:			
Depreciation and amortization expense	53,940	57,092	55,272
Deferred income taxes, net of valuation allowance	(8,629)	(4,881)	(5,422)
Deferred recovery of pension and postretirement costs	9,865	(42,252)	52,230
Deferred regulatory liability	(3,911)	20,538	22,367
Employee benefit expense (less than) greater than funding	(6,859)	43,780	(44,918)
Net fair value changes related to interest rate swap	(35)	575	(1,126)
Changes in assets and liabilities:			
Decrease (increase) in receivables	9,453	(5,907)	9,727
(Increase) decrease in study and interconnection receivables	(12,610)	69,639	(71,053)
(Increase) in prepaid expenses and other	(4,160)	(6,973)	(8,023)
Decrease (increase) in deferred FERC fees	408	3,394	(3,802)
(Increase) decrease in prepaid income taxes	2	3,627	(3,770)
(Decrease) increase in accounts payable and accrued expenses	(12,873)	52,009	1,544
Increase (decrease) in study and interconnection payables	13,838	(72,364)	70,737
Increase (decrease) in accrued payroll and benefits	382	(84)	(246)
Increase (decrease) in deferred FERC fee liability	2,626	-	(1,108)
(Decrease) increase in deferred revenue	(62)	141	263
Refunds to members	(318)	(23,890)	(21,169)
Net cash provided by operating activities	42,013	95,324	52,457
Cash flows (used in) investing activities:			
Cost of projects in development	(30,578)	(31,066)	(35,467)
Note receivable	(926)	(2,816)	1,211
Net cash (used in) investing activities	(31,504)	(33,882)	(34,256)
Cash flows from (used in) financing activities:			
Borrowings under line of credit	124,905	952,352	1,709,805
Repayments under line of credit	(124,905)	(983,748)	(1,678,409)
Repayments of long-term debt	(12,855)	(12,857)	(12,161)
Increase (decrease) in due to members	137,515	4,745	(226,901)
Increase (decrease) in deposits	54,991	226,151	(53,317)
Net cash provided by (used in) financing activities	179,651	186,643	(260,983)
Net increase (decrease) in cash and cash equivalents	190,160	248,085	(242,782)
Cash and cash equivalents balance (including customer deposits), beginning of year	1,124,460	876,375	1,119,157
Cash and cash equivalents balance (including customer deposits), end of year	$ 1,314,620	$ 1,124,460	$ 876,375
Cash paid during the year for:			
Interest	$ 1,791	$ 2,327	$ 2,767
Income taxes	10,244	1,791	4,615
Noncash Activity:			
Projects in development additions included in ending			
Accounts payable and accrued expenses	$ (212)	$ (399)	$ (2,824)

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

December 31, 2015 ($ in tables in thousands)

1. COMPANY OVERVIEW

Background

PJM Interconnection, L.L.C. (PJM or Company) is a Regional Transmission Organization (RTO) responsible for the operation of wholesale electric markets and for centrally dispatching electric systems in the PJM region. PJM's services and the markets PJM operates are subject to regulation by the Federal Energy Regulatory Commission (FERC).

PJM is a limited liability, non-stock company incorporated in the state of Delaware. PJM's Board of Managers is constituted as an independent body, and PJM operates independently from its members.

Nature of Operations

The Company currently coordinates a pooled generating capacity of more than 185,000 megawatts and operates wholesale electricity markets with more than 950 members. PJM enables the delivery of electric power to more than 61 million people in all or parts of Delaware, Illinois, Indiana, Kentucky, Maryland, Michigan, New Jersey, North Carolina, Ohio, Pennsylvania, Tennessee, Virginia, West Virginia and the District of Columbia.

PJM manages a sophisticated regional planning process for generation and transmission expansion to ensure continued reliability of the electric system. Using information technology, PJM provides real-time information to market participants to support their daily transactions and business decision-making. In addition to ensuring the reliable supply of electricity, PJM administers Internet-based bid markets in which participants buy and sell day-ahead and spot market energy, financial transmission rights, synchronized reserves and regulation services.

PJM Settlement, Inc. (PJM Settlement) is a wholly owned subsidiary of PJM, organized as a Pennsylvania nonprofit corporation, and is a FERC-regulated entity. PJM Settlement was formed to handle all of the credit, billing and settlement functions for PJM's members' transactions in the PJM markets and for transmission service. PJM Settlement acts as a counterparty to members' pool transactions in the PJM markets. For the pool transactions in the PJM markets, flash title passes through PJM Settlement immediately prior to passing to the ultimate buyer and seller of the product. This arrangement reinforces PJM's authority to continue to net a member's offsetting financial positions in the PJM markets for credit and billing purposes; provides clarity in PJM Settlement's legal standing to pursue collection from a bankrupt member; and, also complies with the FERC recommendation on credit policy requirements for competitive wholesale electricity markets.

PJM Technologies, Inc. (PJM Tech) is a wholly owned subsidiary of PJM and is not a FERC-regulated entity. PJM Tech was formed to provide service and technology solutions pioneered by PJM to existing and emerging energy markets, system operators and RTOs.

PJM Environmental Information Services, Inc. (PJM EIS) is a wholly owned subsidiary of PJM Tech formed to provide environmental and emissions attributes reporting and tracking services to its subscribers in support of renewable portfolio standards and other disclosure requirements that may be implemented by governmental agencies. PJM EIS is not a FERC-regulated entity.

Tariff Cost Recovery

PJM recovers its administrative costs through three elements under its Open Access Transmission Tariff (Tariff).

The first element is a composite rate, included in PJM stated rate revenues. Beginning October 1, 2011, the composite rate was 29 cents per megawatt-hour (MWh).

The second element is a rider for the Advanced Second Control Center (AC^2). The Tariff establishes a specific mechanism for PJM to collect from its members the actual costs to construct and operate AC^2. The recovery of those costs is from a formula rate set forth in a separate schedule in the Tariff. The recovery is capped at the capitalized investment costs and operating costs of AC^2. PJM began to recover costs under this rider in July 2008. The rider is scheduled to expire seven years from November 2011, which was the in-service date of the AC^2 energy management system.

The third element, included in PJM stated rate revenues, provides for accumulation of a financial reserve and subsequent refunds to PJM's members, if applicable. See further discussion in Footnote 2.

PJM Settlement recovers its administrative costs under a separate schedule under the Tariff.

Summary of Service Fees

	2015	2014	2013
PJM stated rate revenues	$ 237,916	$ 251,209	$ 247,114
PJM AC^2 rider	22,564	27,822	28,005
PJM Settlement revenues	8,230	9,143	7,798
Total service fees	**$ 268,710**	**$ 288,174**	**$ 282,917**

PJM and PJM Settlement have the right to file with the FERC for prospective changes to these rates at any time, if necessary.

2. SIGNIFICANT ACCOUNTING POLICIES

Adoption of New Accounting Standards

Presentation of Deferred Taxes

In November 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2015-17, "Balance Sheet Classification of Deferred Taxes." This ASU amends existing guidance to require that deferred income tax liabilities and assets be classified as noncurrent in a classified balance sheet and eliminates the prior guidance which required an entity to separate deferred tax liabilities and assets into a current amount and a noncurrent amount in a classified balance sheet. The amendments are effective for fiscal years beginning after December 15, 2017. The Company adopted this standard in 2015, and the effect of the retrospective adjustment on the amounts previously presented in the Consolidated Statement of Financial Position at December 31, 2014, was a decrease in Current Assets and a corresponding increase in Non-current Assets of $9.2 million.

Accounting Standards Not Yet Adopted

Revenue Recognition

In May 2014, the FASB issued authoritative guidance to provide a single, comprehensive revenue recognition model for contracts with customers. The guidance contains principles that the Company will apply to determine the measurement and timing of revenue recognition. This guidance will be effective for annual reporting periods beginning after December 15, 2017. The Company is reviewing its revenue recognition policies and disclosures to ensure compliance with the requirements. Adoption of the requirements is not expected to materially affect the Company's results of operations, cash flows or financial positions or existing revenue recognition policies.

Debt Issuance Costs

In April 2015, the FASB issued new guidance related to the classification of debt issuance costs. The guidance requires the presentation of debt issuance costs in the balance sheet as a deduction from the carrying amount of the liability instead of a deferred charge. The guidance is effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within fiscal years beginning after December 15, 2016. The new guidance will be applied on a retrospective basis. The guidance is not expected to affect the Company's financial statements other than presentation on the balance sheet.

Going Concern

In August 2014, the FASB issued authoritative guidance that requires management to assess the ability of the Company to continue as a going concern at each annual and interim reporting period and in certain circumstances. The guidance requires additional disclosures related to liquidity and going concern uncertainties. This guidance will be effective for annual and interim reporting periods ending after December 15, 2016. As this guidance only affects disclosure requirements, the adoption of this guidance will not affect the Company's results of operations, cash flows or financial positions.

Leases

In February 2016, the FASB issued new guidance related to lease accounting. The key objective of the new standard is to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. Lessees will need to recognize a right-of-use asset and a lease liability for virtually all of their leases (other than leases that meet the definition of a short-term lease). For income statement purposes, a dual model has been retained, with leases to be designated as operating leases or finance leases. Expenses will be recognized on a straight-line basis for operating leases and a front-loaded basis for finance leases. For non-public entities, the new standard is effective for periods beginning after December 15, 2019, with early adoption permitted. The new standard must be adopted using a modified retrospective transition and provides for certain practical expedients.
The Company is currently evaluating the affect of the new standard on its financial position, results of operations and cash flows.

Significant Accounting Policies

Basis of Presentation

The accompanying consolidated financial statements have been prepared on an accrual basis in accordance with generally accepted accounting principles in the United States of America (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 requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying disclosures. The following accounting policies are particularly important to PJM's financial position or results of operations, and some require estimates or other judgments of matters of uncertainty. Changes in the estimates or other judgments included within these accounting policies could result in a significant change to the financial statements. These estimates are based on management's best knowledge of current events and actions the Company may undertake in the future. Certain reclassifications have been made to conform to previously reported data to current presentation.

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, 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.

Lease Transactions

The Company accounts for lease transactions as either capital leases or operating leases, depending on the terms of the underlying lease agreements.

Assets leased under a capital lease are recorded at cost, which is the net present value of the future lease payments. Such assets are included in fixed assets in the Company's Consolidated Statement of Financial Position and depreciated using the straight-line method over their estimated useful lives. The aggregate lease payments are recorded as a capital lease obligation, net of interest charges as determined by the excess of lease payments over the cost of the leased asset. This implicit interest cost is charged to expense over the lease term using the effective interest rate method.

The lease payments under an operating lease are recognized as current expenses on an accrual basis over the term of the lease agreement.

Study and Interconnection Activity

Under the Tariff, PJM's transmission provider role is to direct the operation and coordinate the maintenance of the transmission system and indicate, based on studies conducted by PJM, necessary enhancements or modifications to the transmission system. The modifications that are performed on the transmission system, such as network upgrades and generation additions, are conducted principally by third-party vendors at the request of transmission customers. In its system-planning capacity as transmission service provider, PJM provides billing and collection services in the interconnection service agreement process. Billings and collections by PJM for work it performs on behalf of the counterparties to the specific interconnection agreements are reported on a net basis in the Consolidated Statement of Income, Comprehensive Income and Paid in Capital, Retained Earnings and Accumulated Other Comprehensive Income.

Cash Equivalents

Highly liquid investments with maturities of three months or less when purchased are considered cash equivalents.

Concentration of Credit Risk

Financial instruments that subject PJM to credit risk consist primarily of accounts receivable relating to monthly service fee billings. As provided in PJM's Operating Agreement, members are required to either maintain approved credit ratings or to post specified financial security to obtain credit within the PJM markets. During 2015, approximately 61 percent of PJM's operating expenses were billed to 21 of its members, each of which either has an investment-grade credit rating according to at least one of the three major rating services or has provided a guaranty from an affiliate with an investment-grade rating. In comparison, during 2014, approximately 65 percent of PJM's operating expenses were billed to 28 of its members. PJM had approximately 950 members at year-end 2015 and approximately 940 members at year-end 2014.

Under the terms of the PJM Operating Agreement, any payment defaults may be billed to and collected from PJM's other member companies.

Fixed Assets

PJM's fixed assets are comprised principally of software and capitalized software development costs, leasehold improvements, computer hardware and buildings. The costs incurred to acquire and develop computer software for internal use, including financing costs, are capitalized. However, costs incurred prior to the determination of feasibility of developed software and costs incurred following the in-service date of developed software are expensed.

Fixed assets are depreciated or amortized using the straight-line method over the useful lives of the assets as follows:

Software and capitalized software developments costs	3 to 10 years
Computer hardware	3 to 5 years
Building and leasehold improvements	10 to 15 years
Furniture and fixtures	10 years
Buildings	25 years
Vehicles	5 years

Deferred Recovery of Pension and Postretirement Costs

The Company recognizes the funding status of the projected benefit obligation (PBO) of its defined benefit pension plan as a liability in the Consolidated Statement of Financial Position. The PBO represents the actuarial present value of benefits attributable to employee service rendered to date, including the effects of estimated future salary increases. At December 31, 2015, in addition to recording the underfunded PBO as a liability, PJM recorded a regulatory asset to reflect the anticipated future recovery of the amounts expected to be funded in the future through the Company's rate structure. This regulatory asset, which will be amortized each quarter as the net periodic benefit cost of the underfunded liability is recognized, was $11.9 million and $21.8 million at December 31, 2015 and 2014, respectively.

Deferred FERC Fees and Deferred FERC Fee Liability

The FERC charges an annual assessment to all public utilities based on kilowatt-hours of interstate transmission service provided. PJM recovers from its members the annual charges from the FERC. At December 31, 2015, PJM had a $2.6 million deferred FERC fee liability. This liability represents the excess of amounts collected from PJM members and the amount ultimately assessed by the FERC during 2015 and is a factor considered in determining the FERC fee charges billed to PJM members during the subsequent year.

At December 31, 2014, PJM had a $0.4 million deferred FERC fee asset that resulted from under-collections during 2014 and was collected in amounts billed to PJM's members during 2015.

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 service fee revenues, less the revenue collected under the AC^2 rider and the PJM Settlement rate schedule, except that beginning 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. On a quarterly basis, PJM refunds the deferred regulatory liability balance in excess of 6 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. For calendar years 2015, 2014 and 2013, PJM made refunds of $0.3 million, $23.9 million and $21.2 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 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 December 31, 2015 and 2014, the deferred regulatory liability was $7.2 million and $11.4 million, respectively. In both periods, the balance was classified as non-current and represents the PJM reserve.

Deferred Revenue

PJM membership fees, which are billed and collected in advance of the year for which they apply, are amortized ratably over the related annual membership period.

Deposits

At December 31, 2015, the deposits balance was comprised of $83.4 million received for study and interconnection fees and $1,059.4 million for customer credit. At the end of 2014, PJM held deposits of $62.3 million for study and interconnection fees and held deposits of $1,025.5 million for customer credit. These deposits are maintained in separate cash accounts that are not legally restricted.

Income Taxes

PJM has elected to be taxed as a corporation for both federal and state income tax purposes. PJM and its subsidiaries file a consolidated federal income tax return. The consolidated financial statements include prepaid income taxes, accrued income taxes and deferred income taxes. Prepaid income taxes relate to federal and state overpayments on deposit with taxing authorities. These overpayments will be applied to future federal and state income tax liabilities. Deferred income tax assets represent the temporary differences between the Company's financial statement basis and tax basis in existing assets and liabilities measured using presently enacted tax rates. A valuation allowance has been provided against certain deferred tax assets in which management has concluded it is more likely than not the Company will be unable to recognize the income tax benefit associated with those future tax deductions.

Fair Values of Financial Instruments

The carrying amounts reported in the Consolidated Statement of Financial Position for current financial assets and liabilities generally approximate their fair values.

Benefit Plan Accounting

PJM accrues the costs of providing future employee benefits based on assumptions made regarding the valuation of benefit obligations and performance of plan assets. Delayed recognition of differences between actual results and those assumed allows for a relatively even recognition of the effects of changes in benefit obligations and plan performance over the working lives of the employees who benefit under the plans.

In addition to recognizing the underfunded or overfunded PBO of a defined benefit pension plan as an asset or liability in the Consolidated Statement of Financial Position, PJM recognizes annual changes in gains or losses, prior service costs or other credits that have otherwise not been recognized as a part of the liability for pension benefits in the Consolidated Statement of Financial Position. A corresponding regulatory asset, deferred recovery of pension and postretirement costs, has been recognized as a non-current asset in the Consolidated Statement of Financial Position.

PJM's selection of the discount rate, healthcare cost trend rate and expected rate of return on pension assets is based on its review of available current, historical and projected rates, as applicable.

Derivatives

PJM currently has one interest rate swap that qualifies as a derivative instrument. The Company accounts for this derivative as either an asset or liability at fair value in the Consolidated Statement of Financial Position with changes in fair value recorded through earnings. Refer to Footnote 8 for additional details related to PJM's interest rate swap.

An FTR is a financial instrument that enables PJM market participants to reduce their congestion-related price risk when delivering or selling energy on the grid. PJM Settlement is neither the buyer nor seller of FTRs, but as FTR auctions clear, PJM Settlement is temporarily the counterparty to both the FTR buyer and FTR seller. Refer to Footnote 9 for additional details related to FTR derivative disclosures.

Revenue Recognition

PJM recognizes revenue as amounts billed and unbilled under PJM and PJM Settlement's Tariff rate schedules.

Revenues recorded as study and interconnection fees arise from billing and collection services in the interconnection service agreement process performed by PJM. These revenues are offset directly by the corresponding interconnection expenses.

PJM EIS recognizes as revenues amounts both billed and unbilled for the customers of the Generation Attributes Tracking System.

Subsequent Events

PJM has performed an evaluation of subsequent events through March 1, 2016, which is the date the financial statements were issued.

3. ACCOUNTS RECEIVABLE

PJM's receivables at December 31, 2015 and 2014, consisted of the following:

	2015	2014
Billed:		
Membership fees	$ 479	$ 430
PJM EIS	428	188
	907	618
Unbilled:		
Service fees	20,944	30,698
PJM EIS	155	143
	21,099	30,841
Total accounts receivable	**$ 22,006**	**$ 31,459**

PJM's member companies are billed on a monthly basis for recovery of PJM's and PJM Settlement's administrative costs under the Tariff.

All study and interconnection receivables were billed at December 31, 2015 and 2014.

4. FIXED ASSETS

A summary of fixed assets by classification as of December 31, 2015 and 2014, follows:

	2015	2014
Buildings	$ 18,812	$ 18,812
Leasehold improvements	57,279	57,279
Capitalized lease	25,889	25,889
Software development	486,996	466,109
Computer hardware	120,524	114,313
Furniture and fixtures	4,746	4,746
Vehicles	155	155
Subtotal	714,401	687,303
Accumulated depreciation and amortization	(578,200)	(524,503)
Total fixed assets, net of accumulated depreciation and amortization	**$ 136,201**	**$ 162,800**

Amortization of software development costs for the years ended December 31, 2015, 2014 and 2013, was $39.9 million, $40.1 million and $37.6 million, respectively.

Amortization of capitalized lease costs was $1.7 million for each of the years ended December 31, 2015, 2014 and 2013.

Total interest costs incurred for the years ended December 31, 2015, 2014 and 2013, were $2.5 million, $3.3 million, and $2.3 million, respectively.

For the years ended December 31, 2015, 2014 and 2013, interest capitalized for assets under development was $0.6 million, $0.6 million and $0.4 million, respectively.

5. 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 December 31, 2015 and 2014, the outstanding balance due from MA recorded by PJM as a note receivable was $4.1 million and $3.2 million, respectively. At December 31, 2015 and 2014, the current portion of the note receivable was $1.7 million and $0.7 million, respectively. The current balance at December 31, 2015, represents the amount to be repaid in the next 12 months. The non-current portion of the note receivable was $2.4 million and $2.5 million at December 31, 2015 and 2014, respectively.

6. 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. On December 23, 2015, PJM filed with the FERC requesting approval to continue to borrow under this facility. PJM received this approval on February 16, 2016.

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 December 31, 2015, and December 31, 2014. At December 31, 2015 and 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 December 31, 2015 and 2014, the interest rate was 1.329 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.

7. 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 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.

As of December 31, 2015, and December 31, 2014, outstanding borrowings under this loan were $23.4 million and $24.7 million, respectively. As part of the 2013 loan amendment, the interest rate is based on the LIBOR in effect at each reset date plus a spread of 110 basis points. Prior to the amendment, the interest rate was based on the LIBOR in effect at each reset date plus a spread of 135 basis points. The reset date is monthly. As of December 31, 2015 and 2014, the interest rate was 1.344 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 December 31, 2015, and December 31, 2014.

Repayments of principal under the PNC Bank loan agreement are scheduled as follows:

Year Ending December 31,	
2016	$ 1,314
2017	1,314
2018	1,314
2019	1,314
2020	1,314
Remaining	16,810
Total	**$ 23,380**

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 December 31, 2015, and December 31, 2014, outstanding borrowings under the private placement were $11.5 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 December 31, 2015, and December 31, 2014.

The fair value of the Company's existing debt obligations approximates book value at December 31, 2015 and 2014, respectively. The Company determines fair value of its existing fixed-rate debt obligations based on trade data, broker / dealer quotes and other observable market data.

The carrying amounts of its debt obligations approximate fair value because the obligations are currently callable at a price equal to the carrying amounts. The Company considers this to be a Level 2 measurement.

8. 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 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 December 31, 2015, and December 31, 2014, the fair value of the swap of $1.4 million and $1.5 million, respectively, was reported as an interest rate swap in the non-current liability section of the Consolidated Statement of Financial Position.

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

	Year ended December 31, 2015	Year ended December 31, 2014	Year ended December 31, 2013
Unrealized mark-to-market gains (losses)	$ 35	$ (575)	$ 1,126
Total net mark-to-market gains (losses)	$ 35	$ (575)	$ 1,126

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

9. DERIVATIVE FINANCIAL INSTRUMENT – FTRs

PJM Settlement is the central counterparty to members' 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 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 December 31, 2015, was $0.4 billion. A total of 235 members are FTR holders related to a total of 2.4 million megawatt hours. As of December 31, 2015, PJM held $1.4 billion 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 years ended December 31, 2015 and 2014:

$ in millions	
Balance at January 1, 2015	$ 215
Auction additions	859
Settlement and change in fair value	(716)
Balance at December 31, 2015	$ 358
Balance at January 1, 2014	$ 538
Auction additions	468
Settlement and change in fair value	(791)
Balance at December 31, 2014	$ 215

10. 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 levels.

At December 31, 2015 and 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 loan from PNC was 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.

11. INCOME TAXES

Income tax expense shown on the Consolidated Statement of Income and Paid in Capital, Retained Earnings and Accumulated Other Comprehensive Income consisted of the following:

Year ended December 31,	**2015**	**2014**	**2013**
Federal income taxes:			
Current	$ 8,089	$ 4,321	$ 369
Deferred	(6,971)	(3,473)	(1,352)
Change in valuation allowance	-	-	1,895
	1,118	848	912
State income taxes:			
Current	1,907	1,623	96
Deferred	(1,635)	(1,329)	(444)
Change in valuation allowance	4	(1)	(5,574)
	276	293	(5,922)
Income tax expense (benefit)	**$ 1,394**	**$ 1,141**	**$ (5,010)**

During the third quarter of 2013, the Pennsylvania Department of Revenue enacted legislation, which included an expansion of the Net Operating Loss (NOL) deduction limitation. Specifically, the then current NOL deduction limitation (the greater of $3 million or 20 percent of Pa. taxable income) was increased to the greater of $4 million or 25 percent of Pa. taxable income for tax years beginning after December 31, 2013, and to the greater of $5 million or 30 percent of Pa. taxable income for the years beginning after December 31, 2014. The Company had previously recorded a valuation allowance on Pa. State NOLs that it estimated were more likely than not to expire before they could be utilized under the old law. As a result of the law change enacted during the third quarter of 2013, the Company re-evaluated the need for a valuation allowance based on all available evidence. As a result of this analysis, the Company concluded it is more likely than not that the Pa. NOLs would be utilized before they expire and reversed the associated valuation allowance. This reversal reduced tax expense by $3.7 million in 2013. This disclosure is only related to 2013 income tax expense and does not have an impact on the years ended December 31, 2015 and 2014, respectively.

The effects of temporary differences giving rise to deferred income tax assets at December 31, 2015 and 2014, consisted of the following:

	2015	**2014**
Deferred tax liabilities:		
Fixed assets	$(15,397)	$(24,118)
Deferred pension and postretirement costs	(4,848)	(8,853)
	(20,245)	(32,971)
Deferred tax assets:		
Pension	22,183	24,851
Postretirement healthcare	18,347	19,916
Deferred regulatory liability	5,798	6,121
Net operating loss carryforwards	3,997	4,526
Accrued expenses	13,773	12,785
	64,098	68,199
Net deferred income tax assets	43,853	35,228
Valuation allowance	(2,482)	(2,486)
Deferred income tax assets, net	**$ 41,371**	**$ 32,742**

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

Year ended December 31,	2015	2014	2013
Income tax expense (benefit) at the federal statutory rate	$ 790	$ 617	$ (1,622)
Increase (decrease) resulting from:			
Change in valuation allowance	4	(1)	(3,679)
Meals and entertainment	390	290	340
State income taxes, net of federal tax benefit	223	194	(189)
Other	(13)	41	140
Income tax expense (benefit)	**$ 1,394**	**$ 1,141**	**$ (5,010)**

PJM has net operating loss carryforwards of $60.6 million for Pennsylvania state tax purposes that begin expiring in 2021. PJM also had net operating losses for federal income tax purposes that were carried back to prior periods.

PJM and its subsidiaries file a U.S. consolidated federal income tax return and separate company tax returns in the state of Pennsylvania. The statute of limitations is in effect for tax years prior to 2012 for federal purposes and state purposes. There are no ongoing audits at this time.

12. BENEFIT PLANS

Pension Plan

PJM sponsors a defined benefit pension plan (the plan) that covers all regular full-time employees and part-time employees hired prior to January 1, 2014. Benefits under the plan are based on years of service and the employee's compensation. PJM's funding of the plan is determined according to the funding requirements set forth by the Employee Retirement Income Security Act of 1974 (ERISA). Plan assets are invested primarily in stocks and bonds and are monitored by PJM's Benefits Administration Committee. This plan was closed to new participants beginning January 1, 2014. Employees hired on or after January 1, 2014, are given a supplemental benefit in their 401k savings plan (the savings plan) based on their age and years of service.

Supplemental Executive Retirement Plan

PJM also sponsors a Supplemental Executive Retirement Plan (SERP) to provide certain members of senior management with benefits in excess of normal pension benefits. At December 31, 2015 and 2014, the actuarially computed benefit obligation of the SERP included in the other employee benefits liability amounted to $5.1 million and $6.3 million, respectively. Pension expense for this plan was $0.7 million, $0.5 million and $0.6 million for each of the years ended December 31, 2015, 2014 and 2013, respectively. PJM invested $1.0 million in equity securities in January 2003 with the intention to use the proceeds to offset future obligations under the SERP. There were no contributions made during the year ended December 31, 2015. For the year ended December 31, 2014, the Company made contributions of $1.5 million. The investment is included in other non-current assets in the Consolidated Statement of Financial Position at its market value of $4.3 million as of December 31, 2015, and December 31, 2014, respectively.

Deferred Compensation Plan

PJM also sponsors a Deferred Compensation Plan to provide an opportunity to certain members of senior management and the PJM Board of Managers to defer a portion or all of their salary. At December 31, 2015 and 2014, the value of this employee liability amounted to $13.9 million and $10.3 million, respectively. This amount is included in other employee benefits in the Consolidated Statement of Financial Position.

Postretirement Benefits

The Other Postretirement Employee Benefit (OPEB) Plan provides certain healthcare and other benefits to retired employees and their spouses and dependents. The amount of the pre-65 benefit is dependent upon the employee's years of service at retirement. The amount of post-65 benefit at retirement will henceforth be dependent upon the employee's age and years of service as of January 1, 2016. The post-65 OPEB Plan was closed to new hires as of January 1, 2010.

The schedules that follow show the changes in the benefit obligations, plan assets and funded status as of December 31, 2015 and 2014, and components of net periodic pension and postretirement healthcare costs of these plans for the years ended December 31, 2015, 2014 and 2013.

	Pension Benefits				Other Postretirement Benefits	
	Qualified As of December 31,		SERP As of December 31,		As of December 31,	
	2015	2014	2015	2014	2015	2014
CHANGE IN BENEFIT OBLIGATION						
Net benefit obligation at beginning of year	$ 184,505	$ 139,397	$ 6,346	$ 4,927	$ 51,355	$ 39,734
Service cost	10,055	8,049	342	241	1,612	1,624
Interest cost	7,549	6,809	235	240	2,066	1,984
Net transfers in/(out)	2,122	-	(2,006)	-	-	-
Plan participants' contributions	-	-	-	-	34	151
Actuarial loss/(gain)	(15,495)	33,314	216	1,011	(4,613)	8,742
Gross benefits paid	(5,966)	(3,064)	(73)	(73)	(838)	(880)
Net obligation at end of year	**$ 182,770**	**$ 184,505**	**$ 5,060**	**$ 6,346**	**$ 49,616**	**$ 51,355**

PJM uses a measurement date of December 31 for all of its pension and postretirement benefit plans.

	Pension Benefits				Other Postretirement Benefits	
	Qualified As of December 31,		SERP As of December 31,		As of December 31,	
	2015	2014	2015	2014	2015	2014
CHANGE IN PLAN ASSETS						
Fair value of plan assets at beginning of year	$ 129,658	$ 112,579	$ -	$ -	$ 2,315	$ 2,106
Actual return on plan assets	(1,027)	11,143	-	-	130	209
Employer contributions	10,550	9,000	73	73	2,804	729
Plan participants' contributions	-	-	-	-	34	151
Gross benefits paid	(5,966)	(3,064)	(73)	(73)	(838)	(880)
Fair value of plan assets at end of year	133,215	129,658	-	-	4,445	2,315
Funded status at end of year	(49,555)	(54,847)	(5,060)	(6,346)	(45,171)	(49,040)
Unrecognized net actuarial loss	-	-	-	-	-	-
Unrecognized prior service cost	-	-	-	-	-	-
Unrecognized net transition obligation	-	-	-	-	-	-
Net amount recognized at end of year and amounts recognized in the statement of financial position	**$ (49,555)**	**$ (54,847)**	**$ (5,060)**	**$ (6,346)**	**$ (45,171)**	**$ (49,040)**

	Pension Benefits				Other Postretirement Benefits	
	Qualified As of December 31,		SERP As of December 31,		As of December 31,	
	2015	2014	2015	2014	2015	2014
AMOUNTS RECOGNIZED IN DEFERRED PENSION AND POSTRETIREMENT COSTS:						
Net actuarial loss	$ 36,527	$ 43,025	$ 929	$ 1,379	$ (14,284)	$ (10,069)
Prior service (gain) cost	(71)	(106)	30	54	(11,196)	(12,483)
Total	**$ 36,456**	**$ 42,919**	**$ 959**	**$ 1,433**	**$ (25,480)**	**$ (22,552)**

	Pension Benefits				Other Postretirement Benefits	
	Qualified As of December 31,		SERP As of December 31,		As of December 31,	
	2015	2014	2015	2014	2015	2014
Amounts recognized in the statement of financial position consist of:						
Current liability	$ -	$ -	$ (2,133)	$ (640)	$ (978)	$ (916)
Noncurrent liability	(49,555)	(54,847)	(2,927)	(5,706)	(44,193)	(48,124)
Net amount recognized at end of year	**$ (49,555)**	**$ (54,847)**	**$ (5,060)**	**$ (6,346)**	**$ (45,171)**	**$ (49,040)**

At the end of 2015 and 2014, the PBO, the accumulated benefit obligation and the fair value of plan assets for all of the PJM pension and postretirement benefit plans are as follows:

	Qualified		SERP		Other Postretirement Benefits	
	2015	2014	2015	2014	2015	2014
End of Year						
Projected benefit obligation	$ 182,770	$ 184,505	$ 5,060	$ 6,346	$ 49,616	$ 51,355
Accumulated benefit obligation	137,365	136,111	3,888	5,208	49,616	51,355
Fair value of plan assets	133,215	129,658	-	-	4,445	2,315

Expected Cash Flows

Information about expected cash flows for the pension and postretirement benefit plans follows:

	Qualified Benefits	SERP Benefits	Other Postretirement Benefits
Employer Contributions			
Expected employer contributions for 2016 to plan trusts	$ 10,800	$ 2,133	$ 978
Expected employer contributions in the form of direct benefit payments for 2016	-	73	2,804
Expected Benefit Payments			
2016	5,301	2,133	978
2017	5,472	90	1,118
2018	5,853	88	1,256
2019	7,035	122	1,404
2020	7,251	204	1,580
2021-2025	52,967	1,462	11,216

The above table reflects the benefits expected to be paid from the plan or from PJM's assets for PJM's share of the benefit cost. The participants' share of the cost, which is funded by participant contributions to the plan, is not included in this table. Expected contributions to plan trusts reflect expected amounts to be contributed by PJM to the fund.

	Pension Benefits						Other Postretirement Benefits		
	Qualified As of December 31,			SERP As of December 31,			As of December 31,		
	2015	2014	2013	2015	2014	2013	2015	2014	2013
COMPONENTS OF NET PERIODIC BENEFIT COST									
Service cost	$ 10,055	$ 8,049	$ 8,746	$ 342	$ 241	$ 268	$ 1,612	$ 1,624	$ 3,252
Interest cost	7,549	6,809	6,752	235	240	230	2,066	1,984	2,344
Expected return on assets	(9,295)	(8,119)	(6,987)	-	-	-	(162)	(147)	(134)
Prior service cost	(20)	(21)	(23)	8	10	38	(1,287)	(1,287)	(1,058)
Actuarial loss	1,998	-	2,325	109	8	58	(367)	(980)	(270)
Total net periodic benefit cost	**$ 10,287**	**$ 6,718**	**$ 10,813**	**$ 694**	**$ 499**	**$ 594**	**$ 1,862**	**$ 1,194**	**$ 4,134**

For each of the years ended December 31, 2015, 2014 and 2013, $1.4 million, $1.3 million and $0.9 million, of total pension and postretirement benefits expense were included in capitalized project costs, respectively.

The estimated net loss and prior year costs that will be amortized from deferred recovery of pension and postretirement costs into net periodic benefit cost in 2016 are $0.9 million and $1.3 million, respectively.

The following schedule shows the assumptions used to calculate the pension and postretirement benefit obligations for the years ended December 31, 2015, 2014 and 2013.

	Pension Benefits			Postretirement Benefits		
	2015	**2014**	**2013**	**2015**	**2014**	**2013**
Discount rate	4.10%	4.95%	4.20%	4.10%	4.95%	4.20%
Expected return on plan assets	7.00%	7.00%	7.00%	7.00%	7.00%	7.00%
Rate of compensation increase	4.50%	4.50%	4.50%	N/A	N/A	N/A
Medical care cost trend rate						
Current				7.20%	7.40%	7.50%
Ultimate				4.50%	4.50%	5.00%
Years to ultimate				14	15	5

The effect of a 1.00 percent increase in the assumed healthcare cost trend rate from 7.20 percent to 8.20 percent would increase the postretirement benefit obligation as of December 31, 2015, by $3.0 million and the current year postretirement benefit cost by approximately $0.4 million. A 1.00 percent decrease in the assumed healthcare cost trend rate from 7.20 percent to 6.20 percent would decrease the accumulated postretirement benefit obligation by approximately $5.4 million and would decrease the postretirement benefit cost by approximately $0.4 million annually.

The expected return on plan assets assumption has been determined based on PJM's investment objectives and is supported by analysis of simulated investment return using capital market assumptions published in Mercer Investment Consulting's Capital Markets Outlook for the Plan's target asset mix, net of an adjustment for expense to be paid from the plan assets.

The asset allocation for the PJM pension plan and other postretirement benefits plan (the Trust) at the end of 2015 and 2014, and the target allocation for 2015 by asset category, follows. The fair value of plan assets for the Trust was $137.7 million and $132.0 million, at the end of 2015 and 2014, respectively. In addition, the expected long-term rate of return assumption on the plan assets was 7.00 percent in 2015 and 2014.

Asset Category	**Target Allocation**	**2015**	**2014**
Equity securities	50% - 60%	56.0%	55.0%
Debt securities	40% - 50%	44.0%	44.0%
Other	0% - 2%	-	1.0%
Total	**100.0%**	**100.0%**	**100.0%**

The assets of the Trust are invested to provide a source of retirement income for participants and beneficiaries in the plan. The financial objectives of the pension Trust have been established in conjunction with the comprehensive review of the current and projected financial requirements of the plan. The financial objectives of the Trust are to maximize assets in order to consistently and materially exceed the accumulated benefit obligation under the plan and to reduce contributions over time.

The assets of the Trust are invested in accordance with all relevant legislation and regulation, in a manner consistent with fiduciary standards of ERISA and other applicable law. Specifically, the investment program includes such safeguards and diversity to which a prudent investor would adhere, and all transactions undertaken on behalf of the Trust are in the sole interest of plan participants and their beneficiaries.

Fair Value Measurements

The following table presents the Trust assets measured at fair value and their respective levels within the fair value hierarchy as of December 31, 2015 and 2014:

As of December 31, 2015 (a)	**Level 1**	**Level 2**	**Level 3**	**Total**	
Trust Assets:					
Cash Equivalents	$ 468	$ -	$ -	$ 468	
Commingled Funds	-	66,160	-	66,160	(b)
Fixed Income	-	71,032	-	71,032	(c)
Total trust assets	**$ 468**	**$ 137,192**	**$ -**	**$ 137,660**	

As of December 31, 2014 (a)	**Level 1**	**Level 2**	**Level 3**	**Total**	
Trust Assets:					
Cash Equivalents	$ 899	$ -	$ -	$ 899	
Commingled Funds	-	62,680	-	62,680	(b)
Fixed Income	-	68,394	-	68,394	(c)
Total trust assets	**$ 899**	**$ 131,074**	**$ -**	**$ 131,973**	

(a) See Footnote 10 for a description of levels within fair value hierarchy.
(b) The benefit plans own commingled funds that invest in equity and fixed income securities.
(c) This category predominantly represents diverse issues of domestic, investment-grade fixed income securities.

Valuation Techniques Used to Determine Fair Value

Cash equivalents – Investments with maturities of three months or less when purchased, including certain short-term fixed-income securities, are considered cash equivalents and are included in the recurring fair value measurements hierarchy as Level 1.

Commingled funds – Commingled funds are maintained by investment companies and hold certain investments in accordance with a stated set of fund objectives, which are consistent with the PJM overall investment strategy. The values of the majority of commingled funds are not publicly quoted and must trade through a broker. For equity and fixed-income commingled funds traded through a broker, the fund administrator values the fund using the net asset value per fund share, derived from quoted prices in active markets of the underlying securities. These funds have been categorized as Level 2.

Fixed income – For fixed income securities, multiple prices and price types are obtained from pricing vendors whenever possible, which enables cross-provider validations in addition to checks for unusual daily movements. A primary price source is identified based on asset type, class or issue for each security. Fidelity Investments, the fund manager, monitors prices supplied by pricing services and may use a supplemental price source or change the primary price source of a given security if the portfolio managers challenge an assigned price and Fidelity determines that another price source is considered to be preferable. The fixed income securities have been categorized as Level 2.

Savings Plan

PJM also sponsors the 401k Plan (savings plan) for all eligible employees of the Company. The savings plan permits employees to contribute up to 75 percent of their gross compensation on a pretax basis, subject to limitations as described in the savings plan. PJM makes matching contributions equal to 100 percent of the employee's first 5 percent of gross salaries contributed. PJM contributions to the savings plan were approximately $3.7 million, $3.4 million and $3.2 million for the years ended December 31, 2015, 2014 and 2013, respectively. This expense is included in compensation in the Consolidated Statement of Income, Comprehensive Income and Paid in Capital, Retained Earnings and Accumulated Other Comprehensive Income.

13. COMMITMENTS AND CONTINGENCIES

Leases

PJM leases office space under operating leases with various vendors. These leases are noncancelable and expire during the period from 2018 to 2027.

Future minimum rentals under noncancelable lease agreements are as follows:

Year Ending December 31,	Operating	Capital
2016	$ 899	$ 1,778
2017	866	1,831
2018	856	1,883
2019	857	1,936
2020	860	1,989
Remaining	5,039	12,028
Total	**$ 9,377**	**$ 21,445**

OTHER ITEMS

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 its 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. To date, PJM has received approximately $16.8 million, or nearly 99%, 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 Reallocation

Between July 17, 2012, and July 20, 2012, 14 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.

Several parties affected by the Commission's underlying ruling in this matter sought judicial review of the FERC's decision in the D.C. Circuit Court of Appeals, 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. 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 ("Complaint") against PJM with the FERC. In the 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 the 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 and 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 it 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 it is not entitled to consequential damages or lost profits from any asserted delay or non-performance by PJM or the associated transmission owner. PJM will seek to dismiss the Amended Complaint with prejudice on procedural and substantive grounds. 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.

14. RELATED PARTY TRANSACTIONS

PJM occupies two buildings that are owned by a subset of PJM's members. One of the buildings was purchased in 1992 at a cost of $2.9 million. This building was subsequently renovated at a cost of $2.9 million. A second building occupied by PJM and used as one of PJM's Control Centers was purchased in July 1995 at a cost of $4.8 million. Through December 31, 2000, the Facilities Owners elected not to charge PJM rent for the use of these facilities. Effective January 1, 2001, PJM commenced paying a nominal rent of two dollars per year for the use of these facilities. PJM is responsible for facility maintenance, property taxes, insurance and other related costs associated with these two buildings. Estimated annual market rent for these two buildings is approximately $1.6 million.