

**Preliminary Challenges of
Old Dominion Electric Cooperative, Inc. and
North Carolina Electric Membership Corporation
Regarding Virginia Electric and Power Company's
Electric Transmission Formula Rate
True-Up Adjustment for 2015**

December 2, 2016

With respect to the 2015 True-Up of Virginia Electric and Power Company ("VEPCO"), Old Dominion Electric Cooperative, Inc. ("ODEC"), and North Carolina Electric Membership Corporation ("NCEMC") challenge cost items included in VEPCO's 2015 True-Up Update as detailed below in subsection A, "Outstanding Preliminary Challenge Issues."

A. OUTSTANDING PRELIMINARY CHALLENGE ISSUES

1. Skiffes Creek Advertising

ODEC and NCEMC challenge VEPCO's inclusion of the \$876,383 of Advertising related to the Skiffes Creek line in Account 930.1 – General Advertising – that is directly assigned to Transmission (Appendix A, Page 2, Line 78) in the transmission formula rates. This advertising is related to VEPCO's attempt to persuade the retail consumer to support the construction of the Skiffes Creek-Wheaton Project line. VEPCO stated in response to ODEC-NCEMC 2.11 the following:

The advertising program informed customers who live and work in the North Hampton Roads Load Area (which includes the Counties of Charles City, James City and York, and the Cities of Williamsburg, Yorktown, Newport News, Poquoson and Hampton) that Dominion's proposed Skiffes Creek transmission line is needed to address growing demand and ensure that the North Hampton Roads Load Area has the reliable electricity it needs for years to come.

VEPCO's explanation of these advertising costs fails to demonstrate or provide any supporting documentation that the purpose of this advertising falls within the category of advertising costs allowed in VEPCO's formula transmission rates. VEPCO's explanation clearly states that the Company engaged in this advertising to persuade its *retail* consumers to support the issuance of the Army Corps of Engineers permit. (ODEC-NCEMC 1.21 and 2.11) However, VEPCO is seeking to have transmission customers pay these costs. VEPCO included these advertising costs on Appendix A, line 78 – Directly Assigned A&G for General Advertising Exp Account 930.1. That line allocates 100% of the advertising costs to transmission customers. Transmission customers should not be allocated costs that are related primarily to retail customer functions.

2. EPRI Expenses – NA3 Owner – Misc. Contracts

ODEC and NCEMC contend that VEPCO has included \$250,000 of “EPRI Expenses” related to advanced nuclear technology programs in Account 930.2 that should have been excluded from the transmission rates. These costs are more appropriately recorded to FERC Account 524 – Miscellaneous nuclear power expenses. (ODEC-NCEMC 2.12 and 1.22) In response to ODEC-NCEMC 3.10, VEPCO responded that “[u]pon further review of the selected transaction for \$250,000, it was discovered that this transaction was charged to a production function capital project. This charge is reflected in production capital on the Company’s books and was credited out of FERC 930.2.” Notwithstanding this narrative response, VEPCO has not provided any supporting documentation that demonstrates that these EPRI Expenses for \$250,000 were reclassified to production capital. Pending receipt of additional supporting information demonstrating that VEPCO has properly removed these amounts from the true-up of the 2015 formula transmission rates, ODEC and NCEMC challenge what appears to be the inclusion of these amounts in the formula transmission rates because these expenses are related to VEPCO’s production function, and bear no nexus to its provision of transmission service. ODEC and NCEMC seek additional information from VEPCO supporting the statement that these amounts have been excluded from Account 930.2 and the 2015 true-up of the formula transmission rate.

3. Lobbying Expenses in Account 930.2

VEPCO also stated in response to ODEC-NCEMC 3.11 and 3.12 that it was still researching the details regarding any lobbying costs included in Account 930.2. VEPCO stated that if it concludes any amounts should have been recorded to a different FERC account and that the improper recording would have changed the 2015 formula rate Annual Transmission Revenue Requirement, then during 2016 it would record the corrected amount to the proper account. However, it is not clear from VEPCO’s responses whether changing the accounting for these costs in 2016 will result in correcting the 2015 formula rate and providing refunds to customers for the improperly charged amounts. ODEC and NCEMC need additional information to verify that all lobbying have been excluded from Account 930.2 and the 2015 True-Up of the formula transmission rate. Unless and until VEPCO provides sufficient documentation to show that these amounts are properly recorded to Account 930.2, all lobbying costs should be removed from that Account and from the 2015 True-Up.

4. Surry-Skiffes Creek 500kV line materials and supplies

ODEC and NCEMC challenge VEPCO’s inclusion in FERC Account 154 of the materials and supplies (“M&S”) associated with the Surry-Skiffes Creek 500kV line. VEPCO stated in its response to ODEC-NCEMC 3.22 that “materials and supplies ordered within the Skiffe’s Creek Project (992245) originally settled to CWIP – FERC Account 107,” and provided the journal entries and documentation to support this statement. However, in response to ODEC-NCEMC 1.24, VEPCO stated that in 2015, it began transferring the Skiffe’s Creek Project M&S to Account 154. When pressed for justification for this transfer of the Skiffe’s Creek Project M&S from the CWIP account to FERC Account 154, Plant Materials and Operating Supplies, VEPCO stated in response to ODEC-NCEMC 3.20 that the Company does not have written

guidelines, practices or procedures “for the reclassification of material and supplies from a delayed CWIP project back to M&S,” but based its decision on “internal discussions and review of the relevant FERC account descriptions.” ODEC and NCEMC’s review of the descriptions of FERC Account 107 indicates that Account 107 includes “the total of the balances of work orders for electric plant in process of construction.” That description includes M&S associated with any such project. In contrast, Account 154 includes the “cost of materials purchased primarily for use in the utility business for construction, operation and maintenance purposes.” In other words, this account includes purchases of materials and supplies held in inventory until issued to a construction project work order or an operation and maintenance work order. Unused M&S after completion or cancellation of either of the work order types would be returned to Account 154. In this specific instance, the CWIP project has not been cancelled, completed or placed into service, but only delayed until approximately 2017 or early 2018.

Consequently, ODEC and NCEMC maintain that the M&S for Surry-Skiffes Creek should be included in FERC Account 107 – Construction Work in Progress, which is not included in the 2015 Transmission Formula Rate True-Up. VEPCO had specifically assigned these M&S amounts to the Surry-Skiffes Creek 500kV line, which is projected to be completed in 2017, once the Army Corps of Engineering permit is issued. By reclassifying the M&S for the Surry-Skiffes Creek Project back to Account 154, after these amounts had already been specifically assigned to the project and classified in Account 107, VEPCO is in effect seeking recovery of CWIP in the 2015 Transmission Formula Rate True-Up notwithstanding the fact that the formula does not allow recovery of CWIP absent FERC approval. VEPCO has incorrectly reclassified these M&S amounts to Account 154 from Account 107. The Transmission Formula Rate True-Up should only include transmission plant that is in-service and not M&S that VEPCO has assigned or issued to a capital project work order. The Surry-Skiffes Creek 500kV project has not been completed. The work orders and M&S assigned to the project should not be closed or cleared until the project is completed or cancelled. (See FERC Code of Federal Regulations, Uniform System of Accounts: 107 Construction work in progress – Electric, part B, referenced by VEPCO in response to ODEC-NCEMC 3.20.)

VEPCO further states in response to ODEC-NCEMC 3.21 that all of the \$12M in M&S is related to Project BJ (B1905.1) Surry to Skiffes Creek 500kV line, expected to be in-service in November 2017, and that the M&S will be removed from M&S Account 154 at that time. The Surry-Skiffes Creek New 500kV line in the amount of \$94,215,021 is currently reflected in CWIP on FF1, page 216, line 3 and the M&S related to the CWIP project should have remained with the project rather than being reclassified to M&S. It would be inappropriate for VEPCO to wait until the project goes into service to reclassify the M&S directly from Account 154 to Plant-in-Service (Account 101). As noted above, that accounting practice would have the effect of allowing VEPCO to recover a return on CWIP notwithstanding the fact that the formula does not allow such recovery. The M&S had been and should still be classified as CWIP, Account 107. VEPCO should reverse the reclassifications in December 2013 of \$9,924,819 to M&S, December 2014 of \$6,127,936 to M&S and May 2016 of (\$1,950,882) from M&S. (ODEC-NCEMC 1.24, 3.20, 3.21 and 3.22)

5. Contractor Services (customer research) in FERC Account 921

ODEC and NCEMC challenge VEPCO's inclusion of approximately \$200,000 of contractor services for customer research, performed by a research group, included in FERC Account 921 – Office Supplies and Expenses. ODEC-NCEMC Data Request 3.3(b) requested that: "If the customer research work was performed for the distribution function or retail customers, provide a detailed explanation for why the costs were recorded in Account 921." VEPCO did not provide a direct response to this question, and never explicitly stated whether these costs were related to distribution or retail operations. Instead, in response to ODEC-NCEMC 3.3(b), VEPCO stated that "[t]he customer research cost was mistakenly recorded in a manner that charged it to FERC Account 921. Regarding the incorrect recording to FERC 921, Dominion is researching the details. If it is concluded that an associated amount should have been recorded to a different FERC account and such difference would have changed the 2015 formula rate Annual Transmission Revenue Requirement, then during 2016 Dominion will record a reduction to FERC 921 for such amount and record an increase in the FERC account or accounts which should have been charged." This response implies that the costs likely are distribution or retail related. The response further implies that although the costs are distribution or retail related, VEPCO has not removed these costs from Account 921 or from the formula transmission rates. Furthermore, it is not clear from VEPCO's response whether changing the accounting for these costs in 2016 will result in correcting the 2015 formula rate and providing refunds to customers for the improperly charged amounts. Unless and until VEPCO provides sufficient information to demonstrate that it has properly accounted for these expenses, the retail-related customer research work costs should have been recorded in FERC Accounts 903 – 916, and should have been excluded from the true-up of the 2015 Transmission Formula Rates. (ODEC-NCEMC 1.15, 2.5.b and 3.3).

6. Environmental Fee (private party litigation) in FERC Account 921

ODEC and NCEMC challenge VEPCO's inclusion in FERC Account 921 of approximately \$200,000 of environmental fees from a private party litigation where several third parties settled with the EPA and agreed to provide clean up procedures for a facility. VEPCO's response to ODEC-NCEMC 3.4(a) states that the third parties then sued VEPCO and several other entities that had done business with the facility where the contamination occurred in order to recover part of the clean-up costs. VEPCO's response to ODEC-NCEMC 2.5(c) states that "[t]hese environmental fees consist of a one-time settlement for private party litigation." In response to ODEC-NCEMC 3.4(b) as to why non-recurring, one-time settlement fees should be included in FERC Account 921, VEPCO responded that "[t]he Environmental fee was mistakenly recorded in a manner that charged it to FERC Account 921. Regarding the incorrect recording to FERC 921, Dominion is researching the details. If it is concluded that an associated amount should have been recorded to a different FERC account and such difference would have changed the 2015 formula rate Annual Transmission Revenue Requirement, then during 2016 Dominion will record a reduction to FERC 921 for such amount and record an increase in the FERC account or accounts which should have been charged." VEPCO has failed to demonstrate that these environmental fees are appropriately recorded in Account 921 and are appropriately recoverable in the Transmission Formula rate. (ODEC-NCEMC 1.15, 2.5.c and 3.4) Furthermore, it is not clear from VEPCO's response whether changing the accounting for these

costs in 2016 will result in correcting the 2015 formula rate and providing refunds to customers for the improperly charged amounts. These amounts should have been excluded from Account 921 and the true-up of the 2015 formula transmission rate.

7. Legal Services – Disputes, Environmental, Lobbying, Mergers & Acquisitions, and Regulatory issues & filings in FERC Account 923

ODEC and NCEMC challenge VEPCO's inclusion of approximately \$18,409,000 of legal fees for disputes (\$3,463,599), environmental (\$2,358,637), lobbying (\$52,250), mergers & acquisition (\$14,572), and regulatory issues & filings (\$12,519,981), in FERC Account 923. The Code of Federal Regulations, 18, Part 101, Operation and Maintenance, Chart of Accounts for FERC Account 923 – Outside services employed, states:

- A. This account shall include the fees and expenses of professional consultants and others for general services *which are not applicable to a particular operating function or to other accounts.* [Emphasis added]

As stated in the USoA, FERC Account 923 may not include professional consultants that are applicable to a "Particular Operating Function" or that are applicable to "Other FERC Accounts." VEPCO has failed to demonstrate that the legal fees in question are appropriately recorded in Account 923. In response to ODEC-NCEMC No. 3.5, VEPCO objected to providing the information that ODEC and NCEMC deem necessary to determine that each type of legal service, and the total related cost of each, is properly recorded in Account 923 and that such fees are not related to a particular operating function or to other accounts. Although VEPCO provided a list of generic categories of such fees in response to ODEC-NCEMC 3.7 such as bankruptcy, benefits, compliance, etc., that list does not provide sufficient details to allow ODEC and NCEMC to ascertain whether these expenses are related specifically to the distribution, transmission or production functions. Any legal costs, for each of the challenged legal expense types listed (Disputes, Environmental, Lobbying, Mergers & Acquisitions, and Regulatory issues & filings), related to a particular function (production, distribution, transmission, retail customer, etc.) should be recorded to the appropriate O&M, Customer Accounts Expenses, Sales Expenses or A&G expenses account for that function rather than being recorded to Account 923. For example, all legal expenses (internal and outside) related to regulatory filings should be recorded in FERC Account 928 – Regulatory Commission Expenses. All legal expenses related to environmental clean-up of Manufactured Gas Plant sites should be excluded from transmission formula rates and included instead in a production O&M expense account.

In regards to Account 923 and the allocation of the properly recorded outside services employed for "general services," VEPCO is correct that the Wages and Salaries allocation factor properly allocates the costs in the Transmission Formula Rate. However, VEPCO has failed to substantiate that the aforementioned legal services are appropriately recorded in Account 923 in the first place. Until VEPCO provides details regarding the nature of the legal fees recorded in Account 923 sufficient to allow ODEC and NCEMC to ascertain whether those fees relate to non-transmission functions, or to other accounts, ODEC and NCEMC challenge whether all of the above mentioned outside legal services fees included in Account 923 are appropriately

recorded in that FERC account and whether those fees are appropriately recoverable in the Transmission Formula rate. (ODEC-NCEMC 1.17, 2.6 and 3.5).

VEPCO also stated in response to ODEC-NCEMC 3.5 and 3.7 that it was still researching the details regarding any lobbying costs included in Account 923. VEPCO stated that if it concludes that any amounts should have been recorded to a different FERC account and that the improper recording would have changed the 2015 formula rate Annual Transmission Revenue Requirement, then during 2016 it would record the corrected amount to the proper account. However, it is not clear from VEPCO's response whether changing the accounting for these costs in 2016 will result in correcting the 2015 formula rate and providing refunds to customers for the improperly charged amounts. These amounts should be excluded now from Account 923 and the true-up of the 2015 formula transmission rate unless and until VEPCO provides sufficient documentation that these amounts are properly recorded to Account 923.

8. Underground Transmission Costs

ODEC and NCEMC submit a Preliminary Challenge to VEPCO's 2017 Annual Update and 2015 True-Up, with respect to VEPCO's inclusion in the formula transmission rates of the incremental costs of certain underground projects associated with the ODEC and NCEMC's complaint in FERC Docket No. EL10-49-000, pending the outcome of issues set for hearing and the rehearing requests that remain before FERC in that proceeding. Although FERC issued an order in this proceeding in March 2014, several parties, including ODEC and NCEMC, sought rehearing/clarification of that order. Those rehearing requests remain pending before FERC. Moreover, FERC set for evidentiary hearing issues regarding the amount and allocation of undergrounding costs. Exceptions to the Administrative Law Judge's Initial Decision remain pending before FERC. The outcome of FERC's rulings on the rehearing requests and exceptions pending in the Docket No. EL10-49 proceeding will determine the appropriate treatment of this challenge and any required refunds and adjustments to the formula transmission rates. ODEC and NCEMC reserve the right to seek any appropriate adjustments to VEPCO's 2015 True-Up and/or 2017 Annual Update.

B. RESOLVED ISSUES

1. North Carolina (NC) State Income Tax Rate Reductions 2016

At the September 28, 2016, Customer Meeting, ODEC and NCEMC discussed with VEPCO the Company's failure to reflect in the 2017 Formula Rate Projections the known state income tax rate reductions for 2016. In its response to ODEC-NCEMC 2.23, VEPCO stated that upon further review subsequent to the customer meeting, it agreed to adjust the composite state income tax rate in the 2017 Projection of the transmission Formula Rate for the informational filing to be made on or before January 17, 2017. VEPCO agreed to change the composite state income tax rate from 6.03% to 5.86% on Line 132 of the transmission Formula Rate with the corresponding support to be provided in Attachment 5. ODEC and NCEMC agree with this adjustment, subject to review of the supporting detail to be provided with the informational filing to be submitted on January 17, 2017.