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
2018 Annual Update and 2016 True-Up Adjustment

December 8, 2017

With respect to the 2018 Annual Update and 2016 True-Up of Virginia Electric and Power Company's ("VEPCo") transmission formula rate, Old Dominion Electric Cooperative, Inc. ("ODEC") and North Carolina Electric Membership Corporation ("NCEMC") challenge certain cost items related to VEPCo's 2016 True-Up detailed below as the "Outstanding Preliminary Challenge Issues." There are no "Resolved Issues."

OUTSTANDING PRELIMINARY CHALLENGE ISSUES

1. Write-Offs, Obsolete Inventory

ODEC and NCEMC submit a Preliminary Challenge to VEPCo's 2018 Annual Update and 2016 True-Up with respect to the write-offs of obsolete inventory items totaling $1,432,698. In response to ODEC/NCEMC-VEPCO 2.1, VEPCo's Attachment ODEC-NCEMC Set 2-1(a) (MCB) does not reflect any "salvage" value received by VEPCo for any items. ODEC and NCEMC believe that VEPCO should have received salvage value for at least some of these items, *e.g.*, the conductor and other M&S inventory items reflected in the cost-of-service and transmission formula rates. VEPCo should adjust the $1,432,698 total write-offs for obsolete equipment to remove any salvage value received, or provide documentation to demonstrate that it received no salvage value for any of the items written-off as obsolete inventory.

2. Advertising included in Account 566 – Miscellaneous Expenses.

ODEC and NCEMC submit a Preliminary Challenge to VEPCo's 2018 Annual Update and 2016 True-Up with respect to VEPCo's inclusion of $8,498.12 of "Advertising" expenses in FERC Account 566. VEPCO's response to ODEC/NCEMC-VEPCO 2.5.b states that the advertising expenses included in FERC Account 566 were of a promotional nature. FERC requires such advertising to be included in Account 930.1 and not Account 566. FERC Account 566 does not mention advertising expenses, but rather provides for costs associated with labor, materials used and expenses incurred in transmission map and record work, transmission office expenses, and other transmission expenses not provided for elsewhere. However, FERC Account 930.1 – General Advertising Expenses states:

> This account shall include the cost of labor, materials used, and expenses incurred in advertising and related activities, the cost of which by their content and purpose are not provided for elsewhere.

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It further states in Note A:

> Properly includible in this account is the cost of advertising activities on a local or national basis of a good will or institutional nature, which is primarily designed to improve the image of the utility or industry, including advertisements which inform the public concerning matters affecting the company's operations, such as the cost of providing service, the company's efforts to improve the quality of service, the company's efforts to improve and protect the environment, etc.

VEPCO should have recorded the advertising expenses described in response to ODEC/NCEMC-VEPCO 2.5.b in FERC Account 930.1. Thus, VEPCO should remove these expenses from Account 566 and the transmission formula rates.

3. Unfunded Reserves – Accrued Severance Pay, Accrued Other Benefits, and Annual Incentive Plan

ODEC and NCEMC submit a Preliminary Challenge to VEPCo's 2018 Annual Update and 2016 True-Up with respect to VEPCo's failure to reduce transmission rate base by the unfunded reserves for "accrued severance pay," "accrued other benefits" and "annual incentive plan." In its response to Information Request No. ODEC/NCEMC-VEPCO 2.7(d & e), VEPCo reflected that it had recorded B/Y and E/Y balances of approximately $2.0 million and $7.4 million in accrued severance expense. However, VEPCo did not reflect the Accrued Severance Pay Unfunded Reserve amount as a reduction to rate base. In its response to Information Request No. ODEC/NCEMC-VEPCO 2.7(g & h), VEPCo reflected that it had recorded B/Y and E/Y balances of approximately $0.0 million and $0.2 million in accrued other benefits expense. VEPCo did not reflect the Accrued Other Benefits Unfunded Reserve amount as a reduction to rate base. Additionally, in its response to Information Request No. ODEC/NCEMC-VEPCO 2.8(b & c), VEPCo reflected that it had recorded B/Y and E/Y balances of approximately $4.0 million and $43.5 million in accrued annual incentive plan expense. VEPCo did not reflect the Accrued Annual Incentive Plan Unfunded Reserve amount as a reduction to rate base. VEPCo did include the ADIT related to the accrued annual incentive plan expense amount in Account 190, which VEPCo included as an addition to rate base.

VEPCo included both the accrued severance expense and accrued other benefits expense in Account 920, thus including both amounts in the formula transmission rate as a 2016 expense. Additionally, although VEPCo included the accrued annual incentive plan expense in Account 920, and thus included this amount in the formula rate as a 2016 expense, and included the related ADIT recorded in Account 190 in the formula rate as an addition to rate base, it failed to recognize the offsetting reduction to rate base and the corresponding reduction to the formula rate for the related "Unfunded Reserve" recorded.

VEPCo should have recorded the accrued severance pay, accrued other benefits and Annual Incentive Plan unfunded reserves as reductions to rate base to reflect the fact that customers are paying for accrued expenses that have not yet been incurred, and thus are providing cost-free capital to the utility for these amounts. FERC has recognized in multiple formula transmission rates that Accounts 232, 242, 228.1 – 228.4, 253 and 254 properly include "Unfunded Reserves" for labor/payroll related items, such as accrued vacation payable, accrued sick pay payable and accrued severance payable. In Xcel Energy Southwest Transmission ("XEST"), Docket No. ER14-2751-000, FERC stated:

> …we find that XEST's formula rate template should recognize unfunded operations and maintenance costs reserves as a form of cost-free financial capital to XEST. Utilities may accrue monies through charges to operation and maintenance expense to fund contingent liabilities, and such accrued reserves should be deducted from rate base until they are used to fund the liabilities because such reserves represent a cost-free form of financial capital from customers to utilities, not unlike accumulated deferred income taxes (ADIT) which are deducted from rate base. Accordingly, we direct XEST, in a compliance filing, to propose revisions to its formula rate template to credit any unfunded reserves against rate base.

Xcel Energy Southwest Transmission, 149 FERC ¶ 61,182, at P 97 (2014) ("*Xcel*"). The Operation and Maintenance (O&M) Expenses for XEST's transmission formula rates includes both Transmission expenses and A&G expenses.

VEPCO's formula already includes a line to reduce transmission rate base by removing Transmission O&M Reserves. See Appendix A, Page 2, line 47 and Attachment 5 – Cost Support Excel rows 113 – 119. Thus, VEPCO should reflect reductions to rate base for the accrued severance pay, accrued other benefits and Annual Incentive Plan unfunded reserves in the transmission formula rates.

4. Unfunded Reserves – Long Term Disability Reserve VEPCO

ODEC and NCEMC submit a Preliminary Challenge to VEPCo's 2018 Annual Update and 2016 True-Up with respect to VEPCo's failure to reduce transmission rate base by the unfunded reserves for the "long term disability reserve VEPCo." In its response to Information Request No. ODEC/NCEMC-VEPCO 2.16, VEPCo reflected that it had included the ADIT related to the unfunded reserve in FERC Account 190. VEPCo stated:

> As stated in the response to ODEC/NCEMC-VEPCO 1.34, the unfunded reserve related to "Long Term Disability Reserve VEPCO" is not directly included in the NITS Formula Rate as a reduction to rate base. There is not a line in the "Adjustment to Rate Base" section of the NITS Formula Rate to populate this liability balance.

Although VEPCo responds that the NITS Formula Rate does not directly include a line to address the unfunded reserve for the "Long Term Disability Reserve VEPCO" (FERC Account 228.3), the formula provides a remedy for this issue. The ADIT related to the "Long Term Disability Reserve VEPCO" on Excel rows 179 and 180 on Attachment 1 – ADIT and Excel row 189 on Attachment 1A - ADIT are currently included in Column F – Labor Related. VEPCo could change that allocation to Column

C – Production Or Other Related, which would treat both the ADIT and the Unfunded Reserve the same by excluding both from the transmission formula rate.

VEPCo further stated in its response to Information Request No. ODEC/NCEMC-VEPCO 2.16, the following:

> However, the NITS Formula Rate does include a Cash Working Capital adjustment to rate base on Line 57. The Cash Working Capital adjustment is calculated utilizing the 1/8 of O&M expense methodology, which has been approved by FERC. This FERC-approved methodology is used in lieu of a cash working capital adjustment based on a lead/lag study that includes a balance sheet analysis that would include the "Long Term Disability Reserve VEPCO." Thus, the unfunded reserve for "Long Term Disability Reserve VEPCO" is indirectly included in the NITS Formula Rate as a rate base adjustment through the use of the 1/8 of O&M expense methodology to calculate a cash working capital adjustment.

VEPCo has mischaracterized the Cash Working Capital adjustment and the 1/8 of O&M expense methodology as reflecting "cost-free-capital" that is provided by the customers. The 1/8 of O&M methodology only incorporates the utility's cost of funding the O&M expenses and does not take into account the balance sheet analysis that would be included in a lead/lag study. The Cash Working Capital adjustment does not reflect a balance sheet analysis and does not reflect unfunded reserves (cost-free capital to the utility). This is corroborated by FERC's recognition in *Xcel* that multiple formula transmission rates include in Accounts 232, 242, 228.1 – 228.4, 253 and 254 "Unfunded Reserves" for labor/payroll related items, such as accrued vacation payable, accrued sick pay payable and accrued severance payable. *See Xcel* at P 97 (cited above in Preliminary Challenge No. 3).

ODEC and NCEMC request that VEPCO resolve this issue by changing the allocation factor for the "Long Term Disability Reserve VEPCO" from "Labor Related" to "Production Or Other Related."

5. Unfunded Reserves – Retention Bonus

ODEC and NCEMC submit a Preliminary Challenge to VEPCo's 2018 Annual Update and 2016 True-Up with respect to VEPCo's failure to reduce transmission rate base by the unfunded reserves for the "retention bonus." In its response to Information Request No. ODEC/NCEMC-VEPCO 2.17, VEPCo reflected that it had included the ADIT related to the unfunded reserve in FERC Account 190. VEPCo stated:

> As stated in the response to ODEC/NCEMC-VEPCO 1.35, the unfunded reserve related to "Retention Bonus" is not directly included in the NITS Formula Rate as a reduction to rate base. There is not a line in the "Adjustment to Rate Base" section of the NITS Formula Rate to populate this liability balance.

Although VEPCo responds that the NITS Formula Rate does not directly include a line to address the unfunded reserve for the "Retention Bonus" (FERC Account 232), the formula provides a remedy for this issue. The ADIT related to the "Retention Bonus" on Excel rows 361 through 364 on Attachment 1 – ADIT and Excel row 243 on Attachment 1A - ADIT are currently included in Column F – Labor Related. VEPCo could change that allocation to Column C – Production Or Other Related, which would treat both the ADIT and the Unfunded Reserve the same by excluding both from the transmission formula rate.

VEPCo further stated in its response to Information Request No. ODEC/NCEMC-VEPCO 2.17, the following:

> However, the NITS Formula Rate does include a Cash Working Capital adjustment to rate base on Line 57. The Cash Working Capital adjustment is calculated utilizing the 1/8 of O&M expense methodology, which has been approved by FERC. This FERC-approved methodology is used in lieu of a cash working capital adjustment based on a lead/lag study that includes a balance sheet analysis that would include the "Retention Bonus" reserve. Thus, the unfunded reserve for "Retention Bonus" is indirectly included in the NITS Formula Rate as a rate base adjustment through the use of the 1/8 of O&M expense methodology to calculate a cash working capital adjustment.

VEPCo has mischaracterized the Cash Working Capital adjustment and the 1/8 of O&M expense methodology as reflecting "cost-free-capital" that is provided by the customers. The 1/8 of O&M methodology only incorporates the utility's cost of funding the O&M expenses and does not take into account the balance sheet analysis that would be included in a lead/lag study. The Cash Working Capital adjustment does not reflect a balance sheet analysis and does not reflect unfunded reserves (cost-free capital to the utility). This is corroborated by FERC's recognition in *Xcel* that multiple formula transmission rates include in Accounts 232, 242, 228.1 – 228.4, 253 and 254 "Unfunded Reserves" for labor/payroll related items, such as accrued vacation payable, accrued sick pay payable and accrued severance payable. *See Xcel* at P 97 (cited above in Preliminary Challenge No. 3).

ODEC and NCEMC request that VEPCO resolve this issue by changing the allocation factor for the "Retention Bonus" from "Labor Related" to "Production Or Other Related."

6. Unfunded Reserves – Retirement – (FASB 87) VEPCO

ODEC and NCEMC submit a Preliminary Challenge to VEPCo's 2018 Annual Update and 2016 True-Up with respect to VEPCo's failure to reduce transmission rate base by the unfunded reserves for the "Retirement – (FASB 87) VEPCO." In its response to Information Request No. ODEC/NCEMC-VEPCO 2.18, VEPCo reflected that it had included the ADIT related to the unfunded reserve in FERC Account 190. VEPCo stated:

> As stated in the response to ODEC/NCEMC-VEPCO 1.36, the unfunded reserve related to "Retirement – (FASB 87) VEPCO" is not directly included in the NITS

> Formula Rate as a reduction to rate base. There is not a line in the "Adjustment to Rate Base" section of the NITS Formula Rate to populate this liability balance.

Although VEPCo responds that the NITS Formula Rate does not directly include a line to address the unfunded reserve for the "Retirement – (FASB 87) VEPCO" (FERC Account 186), the formula provides a remedy for this issue. The ADIT related to the "Retirement – (FASB 87) VEPCO" on Excel rows 368 and 369 on Attachment 1 – ADIT and Excel row 244 on Attachment 1A - ADIT are currently included in Column F – Labor Related. VEPCo could change that allocation to Column C – Production Or Other Related, which would treat both the ADIT and the Unfunded Reserve the same by excluding both from the transmission formula rate.

VEPCo further stated in its response to Information Request No. ODEC/NCEMC-VEPCO 2.18, the following:

> However, the NITS Formula Rate does include a Cash Working Capital adjustment to rate base on Line 57. The Cash Working Capital adjustment is calculated utilizing the 1/8 of O&M expense methodology, which has been approved by FERC. This FERC-approved methodology is used in lieu of a cash working capital adjustment based on a lead/lag study that includes a balance sheet analysis that would include the "Retirement – (FASB 87) VEPCO" reserve. Thus, the unfunded reserve for "Retention Bonus" is indirectly included in the NITS Formula Rate as a rate base adjustment through the use of the 1/8 of O&M expense methodology to calculate a cash working capital adjustment.

VEPCo has mischaracterized the Cash Working Capital adjustment and the 1/8 of O&M expense methodology as reflecting "cost-free-capital" that is provided by the customers. The 1/8 of O&M methodology only incorporates the utility's cost of funding the O&M expenses and does not take into account the balance sheet analysis that would be included in a lead/lag study. The Cash Working Capital adjustment does not reflect a balance sheet analysis and does not reflect unfunded reserves (cost-free capital to the utility). This is corroborated by FERC's recognition in *Xcel* that multiple formula transmission rates include in Accounts 232, 242, 228.1 – 228.4, 253 and 254 "Unfunded Reserves" for labor/payroll related items, such as accrued vacation payable, accrued sick pay payable and accrued severance payable. *See Xcel* at P 97 (cited above in Preliminary Challenge No. 3).

ODEC and NCEMC request that VEPCO resolve this issue by changing of the allocation factor for the "Retirement – (FASB 87) VEPCO" from "Labor Related" to "Production Or Other Related."

7. Unfunded Reserves – SEPARATION/ERT VEPCO

ODEC and NCEMC submit a Preliminary Challenge to VEPCo's 2018 Annual Update and 2016 True-Up with respect to VEPCo's failure to reduce transmission rate base by the unfunded reserves for the "Separation/ERT VEPCO." In its response to Information Request

No. ODEC/NCEMC-VEPCO 2.19, VEPCo reflected that it had included the ADIT related to the unfunded reserve in FERC Account 190. VEPCo stated:

> As stated in the response to ODEC/NCEMC-VEPCO 1.37, the unfunded reserve related to "Separation/ERT VEPCO" is not directly included in the NITS Formula Rate as a reduction to rate base. There is not a line in the "Adjustment to Rate Base" section of the NITS Formula Rate to populate this liability balance.

Although VEPCo responds that the NITS Formula Rate does not directly include a line to address the unfunded reserve for the "Separation/ERT VEPCO" (FERC Account 232), the formula provides a remedy for this issue. The ADIT related to the "Separation/ERT VEPCO" on Excel rows 372 through 375 on Attachment 1 – ADIT and Excel rows 249 and 250 on Attachment 1A - ADIT are currently included in Column F – Labor Related. VEPCo could change that allocation to Column C – Production Or Other Related, which would treat both the ADIT and the Unfunded Reserve the same by excluding both from the transmission formula rate.

VEPCo further stated in its response to Information Request No. ODEC/NCEMC-VEPCO 2.19, the following:

> However, the NITS Formula Rate does include a Cash Working Capital adjustment to rate base on Line 57. The Cash Working Capital adjustment is calculated utilizing the 1/8 of O&M expense methodology, which has been approved by FERC. This FERC-approved methodology is used in lieu of a cash working capital adjustment based on a lead/lag study that includes a balance sheet analysis that would include the "Retirement – (FASB 87) VEPCO" reserve. Thus, the unfunded reserve for "Retention Bonus" is indirectly included in the NITS Formula Rate as a rate base adjustment through the use of the 1/8 of O&M expense methodology to calculate a cash working capital adjustment.

VEPCo has mischaracterized the Cash Working Capital adjustment and the 1/8 of O&M expense methodology as reflecting "cost-free-capital" that is provided by the customers. The 1/8 of O&M methodology only incorporates the utility's cost of funding the O&M expenses and does not take into account the balance sheet analysis that would be included in a lead/lag study. The Cash Working Capital adjustment does not reflect a balance sheet analysis and does not reflect unfunded reserves (cost-free capital to the utility). This is corroborated by FERC's recognition in *Xcel* that multiple formula transmission rates include in Accounts 232, 242, 228.1 – 228.4, 253 and 254 "Unfunded Reserves" for labor/payroll related items, such as accrued vacation payable, accrued sick pay payable and accrued severance payable. *See Xcel* at P 97 (cited above in Preliminary Challenge No. 3).

ODEC and NCEMC request that VEPCO resolve this issue by changing of the allocation factor for the "Severance/ERT VEPCO" from "Labor Related" to "Production Or Other Related."

8. Unfunded Reserves – Success Share Plan VEPCO

ODEC and NCEMC submit a Preliminary Challenge to VEPCo's 2018 Annual Update and 2016 True-Up with respect to VEPCo's failure to reduce transmission rate base by the unfunded reserves for the "Success Share Plan VEPCO." In its response to Information Request No. ODEC/NCEMC-VEPCO 2.20, VEPCo reflected that it had included the ADIT related to the unfunded reserve in FERC Account 190. VEPCo stated:

> As stated in the response to ODEC/NCEMC-VEPCO 1.38, the unfunded reserve related to "Success Share Plan VEPCO" is not directly included in the NITS Formula Rate as a reduction to rate base. There is not a line in the "Adjustment to Rate Base" section of the NITS Formula Rate to populate this liability balance.

Although VEPCo responds that the NITS Formula Rate does not directly include a line to address the unfunded reserve for the "Success Share Plan VEPCO" (FERC Account 232), the formula provides a remedy for this issue. The ADIT related to the "Success Share Plan VEPCO" on Excel rows 473 and 476 on Attachment 1 – ADIT are currently included in Column F – Labor Related. VEPCo could change that allocation to Column C – Production Or Other Related, which would treat both the ADIT and the Unfunded Reserve the same by excluding both from the transmission formula rate.

VEPCo further stated in its response to Information Request No. ODEC/NCEMC-VEPCO 2.20, the following:

> However, the NITS Formula Rate does include a Cash Working Capital adjustment to rate base on Line 57. The Cash Working Capital adjustment is calculated utilizing the 1/8 of O&M expense methodology, which has been approved by FERC. This FERC-approved methodology is used in lieu of a cash working capital adjustment based on a lead/lag study that includes a balance sheet analysis that would include the "Success Share Plan VEPCO" reserve. Thus, the unfunded reserve for "Success Share Plan VEPCO" is indirectly included in the NITS Formula Rate as a rate base adjustment through the use of the 1/8 of O&M expense methodology to calculate a cash working capital adjustment.

VEPCo has mischaracterized the Cash Working Capital adjustment and the 1/8 of O&M expense methodology as reflecting "cost-free-capital" that is provided by the customers. The 1/8 of O&M methodology only incorporates the utility's cost of funding the O&M expenses and does not take into account the balance sheet analysis that would be included in a lead/lag study. The Cash Working Capital adjustment does not reflect a balance sheet analysis and does not reflect unfunded reserves (cost-free capital to the utility). This is corroborated by FERC's recognition in *Xcel* that multiple formula transmission rates include in Accounts 232, 242, 228.1 – 228.4, 253 and 254 "Unfunded Reserves" for labor/payroll related items, such as accrued vacation payable, accrued sick pay payable and accrued severance payable. *See Xcel* at P 97 (cited above in Preliminary Challenge No. 3).

ODEC and NCEMC request that VEPCO resolve this issue by changing of the allocation factor for the "Success Share Plan VEPCO" from "Labor Related" to "Production Or Other Related."

9. Unfunded Reserves – Workers Compensation – FAS 112

ODEC and NCEMC submit a Preliminary Challenge to VEPCo's 2018 Annual Update and 2016 True-Up with respect to VEPCo's failure to reduce transmission rate base by the unfunded reserves for the "Workers Compensation – FAS 112." In its response to Information Request No. ODEC/NCEMC-VEPCO 2.21, VEPCo reflected that it had included the ADIT related to the unfunded reserve in FERC Account 190. VEPCo stated:

> As stated in the response to ODEC/NCEMC-VEPCO 1.39, the unfunded reserve related to "Workers Compensation – FAS 112" is not directly included in the NITS Formula Rate as a reduction to rate base. There is not a line in the "Adjustment to Rate Base" section of the NITS Formula Rate to populate this liability balance.

Although VEPCo responds that the NITS Formula Rate does not directly include a line to address the unfunded reserve for the "Workers Compensation – FAS 112" (FERC Account 228.3), the formula provides a remedy for this issue. The ADIT related to the "Workers Compensation – FAS 112" on Excel rows 500 and 501 on Attachment 1 – ADIT and on Excel row 260 on Attachment 1A - ADIT are currently included in Column F – Labor Related. VEPCo could change that allocation to Column C – Production Or Other Related, which would treat both the ADIT and the Unfunded Reserve the same by excluding both from the transmission formula rate.

VEPCo further stated in its response to Information Request No. ODEC/NCEMC-VEPCO 2.21, the following:

> However, the NITS Formula Rate does include a Cash Working Capital adjustment to rate base on Line 57. The Cash Working Capital adjustment is calculated utilizing the 1/8 of O&M expense methodology, which has been approved by FERC. This FERC-approved methodology is used in lieu of a cash working capital adjustment based on a lead/lag study that includes a balance sheet analysis that would include the "Workers Compensation – FAS 112" reserve. Thus, the unfunded reserve for "Workers Compensation – FAS 112" is indirectly included in the NITS Formula Rate as a rate base adjustment through the use of the 1/8 of O&M expense methodology to calculate a cash working capital adjustment.

VEPCo has mischaracterized the Cash Working Capital adjustment and the 1/8 of O&M expense methodology as reflecting "cost-free-capital" that is provided by the customers. The 1/8 of O&M methodology only incorporates the utility's cost of funding the O&M expenses and does not take into account the balance sheet analysis that would be included in a lead/lag study. The Cash Working Capital adjustment does not reflect a balance sheet analysis and does not reflect unfunded reserves (cost-free capital to the utility). This is corroborated by FERC's recognition in *Xcel* that multiple formula transmission rates include in Accounts 232, 242, 228.1 – 228.4, 253 and 254 "Unfunded Reserves" for labor/payroll related items, such as accrued vacation payable, accrued sick pay payable and accrued severance payable. *See Xcel* at P 97 (cited above in Preliminary Challenge No. 3).

ODEC and NCEMC request that VEPCO resolve this issue by changing of the allocation factor for the "Workers Compensation – FAS 112" from "Labor Related" to "Production Or Other Related."

10. Industry Association Dues

ODEC and NCEMC submit a Preliminary Challenge to VEPCo's 2018 Annual Update and 2016 True-Up with respect to VEPCo's inclusion in the formula transmission rates of the industry association dues for: (a) Institute of Nuclear Power ("INP") in the amount of $3,383,092; (b) Nuclear Energy Institute ("NEI") in the amount of $1,544,235; and (c) Westinghouse Electric Co. LLC in the amount of $1,508,863, for a total of $6,436,189. (ODEC/NCEMC-VEPCO 2.09) These three items which are included in industry association dues are 100% related to the production function, and the amounts for INP and NEI are related 100% to the nuclear production function, and should be treated in a manner similar to the EPRI dues that VEPCO has excluded because they are production-related costs. VEPCo, by allocating these three items to the transmission formula rates using the Wages and Salary Allocator has overstated transmission expenses and revenue requirements by approximately $480,000.

11. Industry Association Dues – EPRI

ODEC and NCEMC submit a Preliminary Challenge to VEPCo's 2018 Annual Update and 2016 True-Up with respect to VEPCo's inclusion in the transmission O&M expenses included in the formula transmission rates of EPRI industry association dues for: (a) Account 560 in the amount of $181,169; (b) Account 566 in the amount of $18,413; and (c) Account 568 in the amount of $360,099 for a total of $559,681. (ODEC/NCEMC-VEPCO 2.14) VEPCo understates A&G expenses and overstates transmission O&M Expenses. VEPCo reflects an adjustment on Appendix A, Page 3, Line 73 to exclude all EPRI dues from A&G. That adjustment removes approximately $3.5 million from A&G, notwithstanding the fact that VEPCo had included only $3 million in EPRI expenses in that line item. VEPCO then included some of the EPRI dues (as reflected above) in O&M expenses. These EPRI dues should be treated as A&G expenses rather than as O&M expenses. Recording the $550,681 in EPRI dues in transmission O&M accounts, and then including these same expenses in the adjustment to A&G on Appendix A, Page 3, Line 73, $41,084 ($550,681 x 7.3406%) results in a mismatch. Transmission O&M expenses are included at 100%, while A&G expenses are included at the Wages & Salaries Allocation Factor of 7.3406%. VEPCo has overstated transmission expenses and transmission revenue requirements by approximately $526,000, which reflects the amount of EPRI dues improperly treated as O&M expense net of the impact of the 1/8 Cash Working Capital of approximately $7,403.

12. Virginia Department of Emergency Management

ODEC and NCEMC submit a Preliminary Challenge to VEPCo's 2018 Annual Update and 2016 True-Up with respect to VEPCo's inclusion in the A&G expenses in the formula transmission rates of a $1,694,897 payment to the Commonwealth of Virginia Department of Emergency Management for radiological planning support (*i.e.*, monitoring and assistance, state allocation, equipment, etc.). This cost is related to VEPCO's production function and should be recorded in either FERC Account(s) 506, 524, 539, 549 and/or 557, and therefore should be excluded from transmission rates.

13. Virginia Department of Environmental Quality Civil Charge

ODEC and NCEMC submit a Preliminary Challenge to VEPCo's 2018 Annual Update and 2016 True-Up with respect to VEPCo's inclusion in the formula transmission rates of $259,535 recorded in FERC Account 921 associated with a Virginia Department of Environmental Quality Civil Charge. (ODEC/NCEMC-VEPCO 2.26.b) That charge is related to VEPCO's discharge of approximately 22,500 gallons of mineral oil from transformers in Augusta and Arlington Counties. VEPCo should have recorded this "Civil Charge" which is equivalent to a penalty or fine, to FERC Account 426.3 – Penalties. That account is not included in the formula transmission rate. FERC Account 426.3 – Penalties states:

> This account shall include payments by the company for penalties or fines for violation of any regulatory statutes by the company or its officials.

The Civil Charge in the amount of $259,535 levied by the Virginia Department of Environmental Quality should be reclassified from FERC Account 921 to FERC Account 426.3 and excluded from transmission rates.

14. GSU/Interconnections for Generation Projects X2-076 and T157

ODEC and NCEMC submit a Preliminary Challenge to VEPCo's 2018 Annual Update and 2016 True-Up, with respect to the apparent exclusion by VEPCo of the Generator Step-Up facilities ("GSU") and Generator Interconnect Facilities ("Interconnections") related to generation projects X2-076 and T157 (ODEC/NCEMC-VEPCO 2.32) on lines 16 and 17 of Attachment 5. According to the referenced response, Project X2-076, a 1551 MW, combined cycle power station, was interconnected in January 2016, but there are no GSU/Interconnection facilities reflected for January 2016 for this combined cycle power station. Additionally, Project T157, a 160 MW, wind generation facility, was interconnected in December 2016, but there are no GSU/Interconnection facilities reflected for a wind generation facility in December 2016. (Revised ODEC/NCEMC-VEPCO 1.60 and 1.61) VEPCo, per discussions at the 2018 Customer Meeting, provided revised responses to ODEC/NCEMC-VEPCO 1.60 and 1.61. Those responses provide some additional clarity, for which we are thankful, but did not resolve ODEC and NCEMC's concerns.

The GSU/Interconnect facilities associated with generation projects X2-076 and T157 should be identified and reflected in the totals on Attachment 5. To the extent any GSU costs associated with these facilities are included in the transmission formula rate, VEPCO should identify the costs and exclude them.

15. National Renewable Energy Lab

ODEC and NCEMC submit a Preliminary Challenge to VEPCo's 2018 Annual Update and 2016 True-Up with respect to VEPCo's inclusion in the formula transmission rates of $106,500 associated with the National Renewable Energy Lab. VEPCo's response to ODEC/NCEMC-VEPCO 2.34 states:

> Deloitte was engaged in 2016 to express an opinion on whether the Entity complied, in all material respects with the types of compliance requirements described in the DOE Audit Guide that could have a direct and material effect on each of its major DOE federal awards, as identified by management (Solar Pathways and Virginia Offshore Wind Technology Advancement Program), and prepare the schedule of findings and questions costs for the year ending December 31, 2015.

Based on VEPCo's response above, the $106,500 is associated with production facilities and VEPCO should have recorded these costs in a production expense account, possibly FERC Account 549 – Miscellaneous Other Power Generation Expenses or FERC Account 557 – Other Expenses. This amount should be removed from the formula transmission rate.

16. Outside Services Employed – Account 923 – Legal (Confidential)

ODEC and NCEMC submit a Preliminary Challenge to VEPCo's 2018 Annual Update and 2016 True-Up with respect to VEPCo's inclusion in the formula transmission rates of $758,775.79 in legal services booked in FERC Account 923. The Code of Federal Regulations, 18, Part 101, Operation and Maintenance, Chart of Accounts for FERC Account 923 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]

VEPCo has not provided any information demonstrating that the legal services associated with these costs were (1) specifically related to general services which are not applicable to a particular operating function (production, transmission, or distribution); or (2) to other accounts. By not providing support demonstrating that the legal services were related to general services rather than specific functions, VEPCO has not demonstrated that the costs should be included in transmission rates. It is possible that the legal services at issue are related to a specific operating function such as the production or distribution function, and thus should have been recorded in an operating function expense account related to one of those functions. Alternatively, it is possible that the challenged legal services may be related to settlements of employee labor disputes, where the Company could have been found guilty of discriminatory labor practices. In such a case, the legal expenses should have been recorded in FERC Account

426.5 – Other Deductions. VEPCO should exclude these legal fees from transmission rates unless and until it can demonstrate that the legal services are related to the transmission function.

17. Surry-Skiffes Creek 500kV Line Materials and Supplies

ODEC and NCEMC challenge VEPCo's inclusion in FERC Account 154 – M&S, and thus in transmission rates, of the materials and supplies ("M&S") associated with the Surry-Skiffes Creek 500kV line. VEPCo stated in its response to ODEC-NCEMC 1.62

> Skiffes Creek related materials and supplies not yet utilized for construction work in progress are reflected in the average Materials & Supplies balance included in the formula rate true-up for 2016, consistent with the treatment in the formula rate true-up for 2015. This treatment is also consistent with the Company's proposed methodology to resolve the Skiffes Creek M&S Issue.

This issue remains outstanding in the 2015 true-up discussions, as well as in the 2013 and 2014 true-ups. ODEC and NCEMC disagree with VEPCo's proposed method of resolving the outstanding Skiffes Creek M&S issue. We have separately sent VEPCO a response on that outstanding issue concomitantly with these Preliminary Challenges, and incorporate that reasoning set out in that response by reference as justification for this Preliminary Challenge. ODEC and NCEMC still oppose treatment of these facilities as M&S inventory and request that the Skiffes Creek M&S be reflected in FERC Account 107 – Construction Work in Progress for the current year. ODEC and NCEMC believe that VEPCo has incorrectly recorded these facilities in M&S, and thus corrections to prior year true-ups are required under the formula rate implementation protocols.

18. Underground Transmission Costs

ODEC and NCEMC submit a Preliminary Challenge to VEPCo's 2018 Annual Update and 2016 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 the clarification and rehearing requests that remain pending before FERC in that proceeding. FERC issued an order in that proceeding in March 2014 ruling that the incremental costs of certain underground transmission facilities should be removed from rates charged to wholesale customers in North Carolina. On October 19, 2017, FERC affirmed in part and reversed in part the Presiding Administrative Law Judge's ruling quantifying the costs to be removed. VEPCO, ODEC (jointly with other wholesale transmission customers), and NCEMC each separately submitted requests for clarification and/or rehearing. Those pleadings remain pending before FERC.   The final order in Docket No. EL10-49 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 such appropriate adjustments to VEPCo's 2016 True-Up and/or 2018 Annual Update.