

173 FERC ¶ 61,248
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: James P. Danly, Chairman;
Neil Chatterjee and Richard Glick.

Dominion Energy Transmission, Inc.

Docket No. FA15-16-000

ORDER ON PAPER HEARING

(Issued December 17, 2020)

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1. This case is before the Commission for review of one audit finding and certain related recommendations contained in the November 8, 2017 Audit Report¹ prepared by the Division of Audits and Accounting (DAA) in the Office of Enforcement (audit staff), and contested by Dominion Energy Transmission, Inc. (DETI). DETI contests the Report’s finding that DETI’s decision to use its parent company’s consolidated book balances and rates of return instead of its own short-term debt and CWIP balances when computing its Allowance for Funds Used During Construction (AFUDC) was improper, and contests the Report’s recommendations for correcting DETI’s accounting records with respect to DETI’s calculation (and eventual capitalization) of AFUDC. In this order, we affirm the Audit Report’s finding and related corrective recommendations.

I. Audit History and Report

2. As of March 2018 when briefing was completed, DETI, headquartered in Richmond, Virginia was a wholly owned subsidiary of Dominion Energy Gas Holdings, LLC (Dominion Energy Gas Holdings), which in turn was a wholly owned subsidiary of Dominion Energy, Inc. (Dominion).² Prior to September 2013, Dominion was DETI’s direct parent. DETI is an interstate natural gas transmission pipeline company engaged in transmission and storage of natural gas by way of its interstate pipeline and storage

¹ *Dominion Energy Transmission, Inc.*, Docket No. FA15-16-000, Audit Report (Nov. 8, 2017) (delegated order) (Audit Report or Report). (DETI’s September 27, 2017 Response to a draft of the audit report is appended to the Audit Report. (DETI September 27, 2017 Response).

² Dominion was previously known as Dominion Resources, Inc., and changed its name to Dominion Energy, Inc. effective May 10, 2017.

systems in Pennsylvania, Ohio, West Virginia, Virginia, Maryland and New York. DETI primarily provides firm and interruptible transportation and storage services to customers such as local gas distribution companies, marketers, interstate and intrastate pipelines, electric power generators, and natural gas producers. DETI's affiliates include Virginia Electric and Power Company d/b/a Dominion Energy Virginia and Dominion Energy North Carolina, The East Ohio Gas Company d/b/a Dominion East Ohio, Dominion Natrium Holdings, Inc., Hope Gas, Inc. d/b/a Dominion Energy West Virginia, Dominion Energy Cove Point LNG, LLC, Tioga Properties, LLC, Dominion Energy Cove Point LNG, LP, and Dominion Energy Services, Inc. (DES).

3. On April 15, 2015, audit staff commenced an audit to evaluate DETI's compliance with accounting regulations of the Uniform System of Accounts; reporting requirements of the FERC Form No. 2, Annual Report; and DETI's FERC Gas Tariff.³ The audit resulted in the Audit Report prepared by DAA, which sets forth audit staff's findings and recommendations with respect to whether DETI complied with the Commission's accounting regulations, FERC Form No. 2 requirements, and DETI's FERC Gas Tariff. On November 8, 2017, the Director of the Office of Enforcement issued the delegated letter order approving the uncontested audit findings and recommendations and noting the one contested audit finding and associated recommendations in the Audit Report.⁴

4. The Audit Report identified six areas of noncompliance: (1) Calculation of Allowance for Funds Used During Construction (AFUDC) Rates and Accrual; (2) Allocation of Overhead Costs to Construction Work In Progress (CWIP); (3) Accounting for Greenlick Storage Fire Gas Loss Regulatory Asset; (4) Accounting for Employment Discrimination Settlements or Judgments; (5) Accounting for Lobbying Expenses; and (6) Filing of Proposed Accounting for the Sale of Gas Plant Assets. The Audit Report made recommendations to remedy each of the areas of non-compliance and recognized that DETI's September 27, 2017 Response did not challenge non-compliance findings (2) through (6), but did challenge finding.

5. Specifically, with respect to finding (1), the Audit Report concluded that DETI violated Gas Plant Instruction (GPI) No. 3(17), Allowance for Funds Used During Construction,⁵ found in the Commission's accounting regulations for regulated natural

³ *Dominion Energy Transmission, Inc.*, Docket No. FA15-16-000 (Apr. 15, 2015) (audit commencement letter).

⁴ *Dominion Energy Transmission, Inc.*, Docket No. FA15-16-000 (Nov. 8, 2017) (delegated letter order) (Audit Report). DETI's September 27, 2017 Response to a draft of the audit report is appended to the Audit Report. (DETI September 27, 2017 Response).

⁵ 18 C.F.R. Part 201, Gas Plant Instruction No. 3(17) (2020).

gas companies, when it did not use its own book balances and its own cost rates associated with its short-term debt, long-term debt, equity, and CWIP to compute its AFUDC rate as required by the Commission's accounting requirements.⁶ Instead, as noted in the Audit Report, DETI compared its parent entity's monthly consolidated short-term debt balances to its parent entity's monthly consolidated CWIP balances to determine whether CWIP exceeded short-term debt, and in addition used AFUDC rates that were derived from its parent company's consolidated book balances and cost rates. DETI did not request authorization from the Commission to deviate from the method prescribed in GPI No. 3(17) to calculate the maximum AFUDC rate permitted to be used by a regulated natural gas company. The Audit Report states that the AFUDC rates that DETI calculated were higher than the maximum rates calculated using the AFUDC rate formula in GPI No. 3(17), which led to DETI accruing and capitalizing excess AFUDC on construction projects. The Audit Report concludes that, as a result, DETI over-accrued AFUDC by approximately \$54.1 million from 2008 through 2015, as well as overstated accumulated depreciation and accumulated deferred income tax (ADIT) balances.⁷

6. Recommendations 1, 2, 4, and 5 in the Audit Report, to which DETI objects,⁸ are associated with finding (1) and require DETI to:

1. Revise accounting policies and procedures to include its CWIP, equity, and debt balances with associated cost rates in AFUDC rate calculations in accordance with the requirements of GPI No. 3(17), Allowance for Funds Used During Construction.
2. Provide training to relevant staff on the revised AFUDC rate calculation procedures, and develop a training program

⁶ Dominion Energy Transmission, Inc., Filing, Docket No. FA15-16-000 (filed Dec. 8, 2017) (DETI request for shortened procedure to address contested audit finding).

⁷ Audit Report at 1-2, 20.

⁸ DETI does not object to Recommendation 3 and the portion of Finding 1 related to it, which concern inappropriate accrual of AFUDC on plant after such plant was placed in service. *See* Audit Report at 25; *id.* at Appendix: DETI Response, at 5 (stating "DETI disagrees with ... four of the five Recommendations (1, 2, 4, and 5)") (footnote omitted). DETI is therefore deemed under the Commission's regulations to have accepted Recommendation 3 and the portion of Finding 1 relating to it. *See* 18 C.F.R. § 158.1 (2020).

that supports the provision of periodic training in this area, as needed.

4. Recalculate AFUDC accrued each year since 2008 in accordance with the requirements of GPI No. 3(17). Based on the calculations, in periods that the AFUDC rate used exceeded the maximum rate allowed pursuant to GPI No. 3(17), submit a yearly estimate within 180 days of receiving the final audit report, with proposed accounting entries and supporting documentation to DAA that reflects corrections to remove over-accrued AFUDC balances from plant and associated accounts, such as accumulated depreciation and ADIT in DETI's books and records. If the adjusting entries result in a significant impact to income for the current year, DETI may seek approval from the Commission to account for the transaction as a correction of a prior period error in Account 439 [Adjustments to Retained Earnings].

5. Revise gas plant in CWIP and in service, accumulated depreciation, ADIT, and other account balances impacted by over-accrual of AFUDC after receiving DAA's assessment of the proposed accounting entries, and restate and footnote the balances reported in the FERC Form No. 2 in the current and comparative years of the report, as necessary to reflect and disclose the revisions. Consult with DAA in developing appropriate footnote disclosure to ensure the necessary transparency of the impacts on all years affected.⁹

7. DETI's September 27, 2017 Response accepts certain findings and recommendations and identifies the steps it will take to implement those recommendations.¹⁰ However, DETI notes that it disagrees with audit staff's findings and recommendations pertaining to finding (1) related to AFUDC. DETI offers the reasons why it believes that it was permissible for DETI to compute AFUDC using the

⁹ *Id.* at 25-26.

¹⁰ DETI did not contest the portion of finding (1) that DETI inappropriately accrued approximately \$12,000 of AFUDC on a plant after it was placed in service or the related requirement in Recommendation 3, which required it to analyze construction-related work orders and invoices to determine if other similar instances occurred.

book balances of the entity that provides the financing for the pipeline.¹¹ Among other things, DETI argues that its use of its parent company's book balances was "required;" that the Commission has changed its interpretation of GPI No. 3(17); that the Commission should not apply this new interpretation retroactively; and that requiring the accounting adjustment would prevent DETI from recovering a return on its investment, is equivalent to a penalty, and is subject to the general federal five-year statute of limitations. DETI also notes that based on its AFUDC calculations the accounting adjustment would be \$48 million, rather than the \$54.1 million estimated by audit staff.¹²

II. Procedural Matters

8. On December 8, 2017, DETI notified the Commission of its election of the use of shortened procedures for the Commission to review the one contested audit finding and the related recommendations¹³ under Part 158 of the Commission's regulations.¹⁴ On January 22, 2018, pursuant to section 158.3 of the Commission's regulations,¹⁵ the Commission directed the commencement of a paper hearing in this docket, and established a schedule for the filing of initial and reply memoranda. Pursuant to the January 22, 2018 order, DETI and audit staff each filed an Initial Memorandum on March 8, 2018 and a Reply Memorandum on March 28, 2018.

III. Regulatory Framework

9. Sections 4 and 5 of the Natural Gas Act (NGA) require that the Commission ensure that the rates charged by natural gas companies for the transportation of natural gas in interstate commerce are "just and reasonable."¹⁶ To enable the Commission to ensure that such rates are reasonably related to a natural gas company's costs (i.e., are just and reasonable cost-based rates), NGA section 8 requires, among other things, that every natural gas company keep and preserve books and records, including records of cost-accounting procedures, in a manner as may be prescribed by rules and regulations

¹¹ September 27, 2017 Response at 5-10.

¹² *Id.* at 6, n. 9.

¹³ Dominion Energy Transmission, Inc., Filing, Docket No. FA15-16-000 (filed Dec. 8, 2017) (DETI request for shortened procedure to address contested audit finding).

¹⁴ 18 C.F.R. Part 158 (2020).

¹⁵ *Id.* § 158.3.

¹⁶ 15 U.S.C. §§ 717c, 717d (2018).

promulgated by the Commission.¹⁷ In fulfillment of NGA section 8, the Commission enacted Part 201 of its regulations, which memorializes a Uniform System of Accounts Prescribed for Natural Gas Companies Subject to the Provisions of the Natural Gas Act.¹⁸ The Commission promulgated a largely similar set of accounts to enable cost-based regulation of electric public utilities.¹⁹

10. Among other things, the Commission's accounting regulations, for both gas and electric regulated utilities, permit a regulated entity to account for, and recover, the costs related to its investment in – i.e., construction of – new facilities in the following manner: the regulated entity is permitted immediately to place its actual construction costs, when incurred, into Account No. 107, Construction Work in Progress (CWIP), and then transfer these costs when the related facility goes into service to Account No. 101 (plant-in-service) to be recovered through depreciation, with the utility getting its long-term rate of return on the sums in Account No. 101 not yet recovered through depreciation. In addition, during the period that a particular facility is under construction and has not yet been put in service, a regulated entity is permitted to earn a return on the funds used for construction of such specific facility, i.e., a return on its construction costs in Account No. 107. This return on construction costs during the period of construction is referred to by its common accounting term – Allowance for Funds Used During Construction (AFUDC). The regulated entity periodically calculates AFUDC by applying its AFUDC rate to its construction costs or CWIP in Account 107, and then “capitalizes” the resulting AFUDC amount by adding it to the CWIP in Account 107 for the facility under construction. When the specific facility goes into service, the entire amount of costs pertaining to that facility in Account 107 (made up of the actual construction costs plus the capitalized return on them during the period of construction) is transferred to Account 101 as the base cost of the new facility in service and is recovered through depreciation while earning a long-term rate of return until such recovery.²⁰ At issue in this proceeding

¹⁷ *Id.* § 717g.

¹⁸ 18 C.F.R. Part 201 (2020).

¹⁹ *See id.* Part 101.

²⁰ *See, e.g., Central Illinois Light Co.*, 10 FERC ¶ 61,248, at 61,477 (1980) (“While plant is under construction, the costs of construction are carried in a non-rate base account, Construction Work in Progress (CWIP) (Account 107). AFUDC is included in this account as one cost of construction. Once the completed facilities are placed in service, the amounts in the CWIP account are transferred to the Plant in Service Account (Account 101), which is a rate base account. The company thereafter may recover the cost of the facilities, through depreciation, and a return thereon, over the life of the facilities.”), *aff'd in part and remanded in part, Villages of Chatham and Riverton, Ill. v. FERC*, 662 F.2d 23 (D.C. Cir. 1981).

is how DETI calculated its AFUDC rate – that is, the return on its construction costs or CWIP in Account 107 during the period of a facility’s construction before the facility was placed in service.

11. Prior to 1977, the Commission’s predecessor (the Federal Power Commission (FPC)) permitted regulated entities to calculate and apply an AFUDC rate reflecting their financing costs but capped at 6.5 percent for all regulated entities. In 1977, however, the FPC enacted Order No. 561, which, among other things, established a formula that, when applied to a specific regulated entity’s accounts, results in a maximum AFUDC rate specific to that entity, which it may use, but not exceed, in calculating and capitalizing AFUDC.²¹ Specifically, the FPC amended Gas Plant Instruction No. 3(17) to state as follows:

“Allowance for funds used during construction” includes the net cost for the period of construction of borrowed funds used for construction purposes and a reasonable rate on other funds when so used, not to exceed without prior approval of the Commission allowances computed in accordance with the formula prescribed in paragraph (a) below....

(a) The formula and elements for the computation of the allowance for funds used during construction shall be:

$$A_i = s \left(\frac{S}{W} \right) + d \left(\frac{D}{D+P+C} \right) \left(1 - \frac{S}{W} \right)$$

$$A_e = \left[1 - \frac{S}{W} \right] \left[p \left(\frac{P}{D+P+C} \right) + c \left(\frac{C}{D+P+C} \right) \right]$$

A_i = Gross allowance for borrowed funds used during construction rate.

A_e = Allowance for other funds used during construction rate.

S = Average short-term debt.

s = Short-term debt interest rate.

D = Long-term debt.

d = Long-term debt interest rate.

²¹ *Amendments to Uniform System of Accounts for Public Utilities and Licensees and For Natural Gas Companies (Classes A, B, C and D) to Provide for the Determination of Rate for Computing the Allowance for Funds Used During Construction and Revisions of Certain Schedule Pages of FPC Reports*, Order No. 561, 57 FPC 608 (1977), *reh’g denied*, Order No. 561-A, 59 FPC 1340 (1977), *order on clarification*, 2 FERC ¶ 61,050 (1978).

P = Preferred stock.

p = Preferred stock cost rate.

C = Common equity.

c = Common equity cost rate.

W = Average balance in construction work in progress less asset retirement costs (See General Instruction 24) related to plant under construction.

(b) The rate shall be determined annually. The balances for long-term debt, preferred stock, and common equity shall be the actual book balances as of the end of the prior year. The cost rates for long-term debt and preferred stock shall be the weighted average cost determined in the manner indicated in subpart D of part 154 of the Commission's regulations under the Natural Gas Act. The cost rate for common equity shall be the rate granted common equity in the last rate proceeding before the ratemaking body having primary rate jurisdiction. If such cost rate is not available, the average rate actually earned during the preceding three years shall be used. The short-term debt balances and related cost and the average balance for construction work in progress shall be estimated for the current year with appropriate adjustments as actual data becomes available.²²

12. In addition, NGA section 10 requires that every natural gas company shall file with the Commission annual and periodic reports.²³ The Commission codified this requirement in section 260.1 of the Commission's regulations²⁴ by requiring major natural gas companies such as DETI to file an Annual Report identified as FERC Form No. 2.

IV. Memoranda Submitted by DETI and Audit Staff

A. Whether GPI No. 3(17) Is Vague and Authorizes DETI's Actions

DETI Initial Memorandum

²² 18 C.F.R. Part 201, Gas Plant Instruction No. 3(17) (2020).

²³ 15 U.S.C. § 717i (2018).

²⁴ 18 C.F.R. § 260.1 (2020).

13. DETI contends that its approach to calculating AFUDC is correct and accords with the Commission's regulations, precedent, and policy.²⁵ DETI first asserts that its approach is consistent with the text of GPI No. 3(17). More specifically, DETI argues that the text of GPI No. 3(17) is vague, but a reference to Part 154 of the Commission's regulations found in GPI No. 3(17) clarifies that, properly interpreted, GPI No. 3(17) directs pipelines to compute AFUDC using the book balances and the cost rates of the entity that provides their financing.²⁶ DETI argues that GPI No. 3(17) must be read together with Part 154, subpart D of the Commission's regulations, and "can only reasonably be read to mean that in instances where, as here, the capital of the regulated entity is primarily obtained from a company by which the regulated entity is controlled, the AFUDC rate should be determined based on the capital balances and related cost rates of the controlling entity."²⁷

Audit Staff Initial Memorandum

14. Audit staff argues that the Audit Report correctly found that DETI improperly calculated its AFUDC rate, exceeding the maximum rate allowed by the Commission's regulations stated in GPI No. 3(17), and thereby overstating its plant balances. Audit staff contends that DETI over-stated AFUDC because it improperly calculated its AFUDC rate using its parent company's consolidated book balances instead of its own book balances as prescribed by the Commission's formula for capitalizing AFUDC under GPI No. 3(17). Audit staff asserts that DETI's departure from GPI No. 3(17) resulted in DETI inflating its gas plant in service and associated balances by approximately \$54.1 million from 2008 through 2015.²⁸

15. Audit staff asserts that "[n]othing in GPI No. 3(17) directs a company to use book balances other than its own."²⁹ Audit staff contends that the reference to Subpart D of Part 154 of the Commission's regulations found in GPI No. 3(17) relates solely to the method of calculating cost rates for the long-term debt and the preferred stock components of the AFUDC formula, and cannot be construed as a license for DETI to

²⁵ See, e.g., DETI Initial Memorandum at 3-4 ("DETI's use of its parent company's book balances ... complies with Commission regulations, Order Nos. 561 and 561-A, and Commission policy and precedent"); *id.* at 3-20.

²⁶ *Id.* at 3-4.

²⁷ *Id.* at 6 (quoting Guest Aff. at 5:1-4 (Exh. No. DETI-3)).

²⁸ Audit Staff Initial Memorandum at 3 (citing Audit Report at 20).

²⁹ *Id.* at 10.

“use its parent company’s book balances for every component of the formula[.]”³⁰ Moreover, the cross-reference to Part 154, subpart D in GPI No. 3(17) only discusses the cost rates for long-term debt and preferred stock, not for short-term debt.

16. Audit staff states that DETI is incorrect in its claims that prior approval to use its parent company’s consolidated book balances in the calculation of its AFUDC was unnecessary. Audit staff asserts that DETI’s method of accruing AFUDC both departed from GPI No. 3(17) and resulted in an AFUDC rate in excess of the maximum specified in GPI No. 3(17). Citing GPI No. 3(17), audit staff argues that DETI should have sought prior Commission approval, i.e., a waiver of GPI No. 3(17), to use its parent company’s book balances in its AFUDC rate calculation because the AFUDC exceeded the maximum amount calculated by the formula in GPI No. 3(17). Audit staff asserts that GPI No. 3(17) “specifies that actual book balances and associated cost rates” of the regulated entity should be used to determine the maximum AFUDC rate, and DETI “over-accrued its AFUDC rate because it did not use its own ... balances and associated cost rates but rather used those of its parent company.”³¹ Audit staff acknowledges that there may be certain specific instances where the Commission approved the use of a parent company’s capital structure on a case-by-case basis, but concludes that does not mean that use of a parent company’s capital structure was authorized for DETI.³² Accordingly, audit staff argues that DETI should have sought Commission approval to use its parent company’s consolidated book balances in its AFUDC calculations.³³

DETI Reply Memorandum

17. DETI asserts in its reply memorandum that audit staff has not cited any examples of contested Commission proceedings that would bar a regulated natural gas pipeline such as DETI from using its parent’s book balances when computing AFUDC.³⁴ DETI further argues that audit staff is incorrect that DETI should have requested a waiver of GPI No. 3(17) and authorization to exceed the rate calculated using the Commission’s AFUDC rate formula, asserting that the Commission does not require an advance waiver for a pipeline to compute AFUDC using the capital structure of the entity that provides its

³⁰ *Id.* at 10-11.

³¹ *Id.* at 8-9 (footnotes omitted).

³² *Id.* at 11.

³³ *Id.* at 11.

³⁴ DETI Reply Memorandum at 3.

financing.³⁵ DETI claims that if it “believed that a waiver was necessary in this instance, it would have requested one.”³⁶

18. DETI contends that audit staff “misconstrues” GPI No. 3(17) “as requiring that a pipeline use its own book balances to compute AFUDC.”³⁷ DETI asserts that audit staff is “internally inconsistent, given that despite arguing that ‘[n]othing in GPI No. 3(17) directs a company to use book balances other than its own,’ [a]udit [s]taff also recognizes that GPI No. 3(17) requires DETI to derive ‘cost rates for long-term debt and preferred stock’” using the methods of calculating a weighted average cost of such debt or stock based on a prior twelve-month base period that are also used in rate cases.³⁸ DETI further asserts that requiring it “to derive short-term debt and construction work in progress (CWIP) using its own book values” while requiring computation of the cost rate for long-term debt and preferred stock using the twelve-month weighted-average cost method also employed in rate cases violates “the principle that pipelines cannot trace the source of funds used for various corporate purposes.”³⁹

Audit Staff Reply Memorandum

19. In its reply memorandum, audit staff argues that DETI’s actions clearly violated the Commission’s regulations in GPI No. 3(17) regarding calculation of AFUDC. Audit staff contends that the Commission should uphold audit staff’s finding because it is clear that the Commission’s accounting regulations in GPI No. 3(17) direct regulated entities to use their own book balances and cost rates in the regulation’s formula determining a maximum permissible AFUDC rate.⁴⁰ Audit staff argues further that, more specifically and relevant to this case, GPI No. 3(17) requires that where a pipeline’s short-term debt exceeds its CWIP, its maximum AFUDC rate is, solely, its short-term debt rate. DETI, by excluding its own book balances and cost rates and, instead, comparing its parent’s

³⁵ *Id.* (citing *N. Border Pipeline Co.*, 110 FERC ¶ 61,203, at P 3 (2005) (N. Border); *Duke Energy Moss Landing*, 83 FERC ¶ 61,318, at 62,306 (1998); and *Natural Gas Pipeline Co. of America*, 46 FERC ¶ 61,102, at 61,416 (1989) (in other contexts, denied waiver requests as unnecessary where the Commission found applicants had met applicable regulatory requirements).

³⁶ *Id.* at 2.

³⁷ *Id.* at 7 (citing Audit Staff Initial Memorandum at 10-11).

³⁸ *Id.*

³⁹ *Id.* at 8.

⁴⁰ Audit Staff Reply Memorandum at 4-7.

consolidated CWIP to its parent's consolidated short-term debt, improperly opened the door to applying high rates for long-term debt, equity and preferred stock, causing DETI to exceed the maximum AFUDC rate – i.e., solely a short-term debt rate – required by GPI No. 3(17) in DETI's circumstances.⁴¹ The Commission should uphold the finding, audit staff states, to redress DETI's non-compliance with GPI No. 3(17). Audit staff also notes that DETI could have requested a waiver, as prescribed in GPI No. 3(17), seeking permission to exceed the maximum AFUDC rate produced by GPI No. 3(17), at any time, on any grounds it wished to raise, but did not do so.⁴²

20. With respect to DETI's claim that GPI No. 3(17) clearly required DETI to use the book balances of its parent,⁴³ audit staff responds that this regulation "provides no such instructions pertaining to the use of book balances other than those of the utility."⁴⁴ Audit staff argues that the reference to Part 154, subpart D in GPI No. 3(17), upon which DETI relies, relates specifically to determining cost rates for long-term debt and preferred stock. Part 154, subpart D does not reference short-term debt or CWIP and "it does not speak to the use of a parent company's consolidated book balances"⁴⁵ Moreover, audit staff further observes that Part 154, subpart D "relates to the material that must be filed in a rate case It has no application as to whether a particular utility has been approved to use its parent company's book balances." Audit staff concludes that DETI's claim regarding the reference to Part 154, subpart D found in GPI No. 3(17) "blatantly mischaracterizes Commission regulations."⁴⁶

B. Whether Order No. 561 Authorizes DETI's Actions

DETI Initial Memorandum

21. DETI asserts that Order No. 561, which promulgated the AFUDC regulations in GPI No. 3(17), stated that the purpose of the AFUDC rule is to "yield[] the approximate

⁴¹ *Id.* at 7 ("DETI's improper accounting allowed the company to include the cost of unneeded long-term debt, preferred stock, and common equity in its construction operations") (footnote and citation omitted).

⁴² *Id.* at 3, 6, and 13.

⁴³ DETI Initial Memorandum at 5 ("Clearly, GPI No. 3(17) requires a pipeline company to use the book balances of the company that provides its financing").

⁴⁴ Audit Staff Reply Memorandum at 8.

⁴⁵ *Id.* at 9.

⁴⁶ *Id.*

rate of return that would be allowed in a rate case,” and further asserts that DETI’s decision to use the consolidated account balances of its parent entity, rather than DETI’s actual balances, accomplishes this.⁴⁷ In sum, DETI maintains that the way that it calculated AFUDC is consistent with Order No. 561 and furthers the order’s purpose.

Audit Staff Initial Memorandum

22. Contrary to DETI, audit staff asserts that DETI’s actions conflict with the “objective” of Order No. 561 in establishing “the prescribed AFUDC formula,” which audit staff asserts was “to permit a utility to achieve a rate of return on ‘its total utility operations, including its construction program.’”⁴⁸ Audit staff notes that the formula prescribed in Order No. 561 was not “based on financing costs and construction programs of multiple [affiliated] entities both jurisdictional and non-jurisdictional,” as DETI has done. Audit staff further maintains that “[t]he consolidated book balances of DETI’s parent company are not an appropriate reflection of DETI’s cost to finance its construction program,” and in this case use of such “consolidated balances increases DETI’s calculated AFUDC rate above the maximum permitted” by GPI No. 3(17)’s formula.⁴⁹ As a further ground for contending that DETI’s acts were inconsistent with Order No. 561, audit staff explains that in Order No. 561-A “the Commission clarified that if short-term debt balances exceed CWIP, the maximum total AFUDC rate to be utilized will be ‘the weighted average short-term debt rate.’”⁵⁰ Audit staff further states that: “DETI’s short-term debt balances did in fact exceed its CWIP. As such, DETI should have only applied its short-term debt cost rate to its CWIP balances ... resulting in DETI accruing significantly less AFUDC.”⁵¹

DETI Reply Memorandum

23. DETI contends that audit staff “misconstrues Commission precedent, policy[,] and regulations.”⁵² DETI rejects audit staff’s conclusion that Order No. 561 is focused on the book balances of the regulated utility and does not authorize use of a parent entity’s book

⁴⁷ DETI Initial Memorandum at 5.

⁴⁸ Audit Staff Initial Memorandum at 9 (quoting Order No. 561 57 FPC 608 at 608 (emphasis is audit staff’s)).

⁴⁹ *Id.*

⁵⁰ *Id.* at 9-10 (quoting Order No. 561-A, 59 FPC 1340 at 1342).

⁵¹ *Id.* at 10 (footnotes omitted).

⁵² DETI Reply Memorandum at 3.

balances. DETI contends that the purpose of Order No. 561 is to compute AFUDC “at approximately the rate [of return] which would be allowed in a rate case,” and DETI contends it has met this purpose by looking at DETI’s financing from its parent, and that therefore it needed no Commission waiver or prior authorization to do what it did.⁵³

Audit Staff Reply Memorandum

24. Audit staff takes issue with DETI’s assertion that using the “capital structure of the financing entity” fulfills Order No. 561’s purported purpose of yielding an AFUDC rate approximating the “rate of return that would be allowed in a rate case.”⁵⁴ Audit staff maintains that such an argument is not relevant to determining whether DETI complied with GPI No. 3(17) and “should be reserved for seeking Commission approval to exceed” the maximum AFUDC rate permitted under GPI No. 3(17), and that an alleged effort by DETI to “fulfill the purpose of Order No. 561” did not relieve DETI from its obligation to comply with GPI No. 3(17) as it is written.⁵⁵

C. Whether Other Commission Precedent and Policy Support DETI’s Position

DETI Initial Memorandum

25. DETI argues that in numerous similar contexts to that faced by DETI, “the Commission has directed companies that did not issue long-term debt or provide their own financing to use the actual capital structure of the entity that provided their financing in computing AFUDC.”⁵⁶ DETI thus argues that it is well-established that Commission policy requires “use of the actual capital structure of the entity that does the financing for the regulated pipeline, whether that entity is the regulated pipeline itself or its parent.”⁵⁷ DETI notes that the Commission’s Chief Accountant granted waivers requested by two DETI affiliates, Dominion Cove Point LNG, LP and Dominion Carolina Gas Transmission LLC, authorizing each to use its parent’s “capital structure” in calculating its AFUDC rate, and according to DETI this supports a finding that DETI’s conduct was in line with

⁵³ *Id.* at 4 (quoting Order No. 561, 57 FPC 608 at 608).

⁵⁴ Audit Staff Reply Memorandum at 10 (quoting DETI Initial Memorandum at 5).

⁵⁵ *Id.*

⁵⁶ DETI Initial Memorandum at 5-6.

⁵⁷ *Id.* at 11 (quoting *Garden Banks Gas Pipeline*, 78 FERC ¶ 61,066, at 61,240 (1997) (*Garden Banks*)).

Commission regulations, precedent and policy.⁵⁸ DETI further argues that audit staff is incorrect that DETI should have requested a waiver of GPI No. 3(17) and authorization to exceed the rate calculated using the Commission's AFUDC rate formula, arguing that the Commission does not require an advance waiver "for a pipeline to compute AFUDC using the capital structure of the entity that provides its financing."⁵⁹

Audit Staff Initial Memorandum

26. Audit staff notes that Commission policy and precedent support the "potential use" of a parent company's "capital structure" (i.e., the parent's long-term debt to equity ratio)⁶⁰ to calculate an AFUDC rate, in certain limited circumstances, after evaluation and express prior approval by the Commission. However, audit staff argues that there is no Commission policy authorizing a regulated pipeline company, on its own initiative, to disregard its own book balances when calculating AFUDC, as DETI has done. Audit staff adds that it has not suggested that the use of a parent company's capital structure to calculate AFUDC is never appropriate, or that the Commission never requires or directs its use, but Commission policy and precedent supports audit staff's contention that such requirement or direction takes place after Commission evaluation and prior approval.⁶¹ Audit staff asserts that DETI provided no support for its claim that Commission policy and precedent required it to use its parent company's consolidated book balances for the AFUDC rate components.⁶² Indeed, audit staff states that it "is not aware of any instance

⁵⁸ *Id.* at 6, n.16, and 11, n.38 (citing *Dominion Cove Point LNG*, Docket No. AC16-61-000 (Sept. 28, 2016) (delegated order); *Dominion Carolina Gas Transmission LLC*, Docket No. AC16-57-000 (Sept. 28, 2016) (delegated order)).

⁵⁹ *Id.* at 8.

⁶⁰ The term "capital structure" used in Commission orders refers to the structure of an entity's long-term financing (i.e., its long-term debt, common equity and preferred stock) and refers specifically to the ratios of the amount of long-term debt to the total amount of all three sources of long-term financing, and the ratio of the amount of equity (common and preferred) to the total amount of all three sources of long-term financing, as in the phrase 60 percent debt, 40 percent equity. The term does not contemplate short-term debt, or CWIP balances.

⁶¹ Audit Staff Initial Memorandum at 12.

⁶² *Id.* at 12-13.

where the Commission granted approval for the use of a parent company's CWIP balance in a utility's calculation of its AFUDC rate."⁶³

27. Audit staff faults "DETI's unilateral decision to use its parent company's capital to calculate its AFUDC rate" as "not consistent with Commission policy and precedent."⁶⁴ DETI infers that because the Commission has authorized use of a parent company's capital structure in several cases, it was permissible for DETI to rely on its parent company's capital structure. Audit staff does not contest that in the context of specific certificate proceedings or rate cases, the Commission has considered the facts and circumstances presented by an applicant and authorized a pipeline to use its parent company's capital structure.⁶⁵ But, in each of those proceedings, the Commission examined the facts and circumstances of each case before granting authorization to the utility to derive a cost of long-term capital using its parent's capital structure. Audit staff notes that "[t]here was no automatic, unevaluated presumption that the parent company's capital structure would be approved."⁶⁶ DETI could have sought a waiver of GPI No. 3(17) to allow it to use its parent company's capital structure, but it did not.

28. Audit staff concludes that Commission policy and precedent do not support the use of a CWIP book balance other than the utility's own CWIP book balance, in the calculation of its AFUDC rate. Audit staff notes that not only does DETI use its parent company's "capital structure" without approval, DETI goes beyond capital structure and uses its parent's consolidated CWIP and short-term debt balances to determine whether CWIP exceeds available short-term debt financing.⁶⁷

DETI Reply Memorandum

29. In reply, DETI takes issue with audit staff's argument that in the certificate and rate proceedings in which the Commission has approved use of a parent's "capital structure" to determine the cost rate of long-term capital for a pipeline company, the Commission was departing from its preferred policy of using a pipeline's own capital structure, and permitted such departure only after Commission analysis of the specific facts of each case, undermining, according to audit staff, DETI's claim that it did not need Commission approval or a waiver to exclude its own book balances and employ

⁶³ *Id.* at 12.

⁶⁴ *Id.*

⁶⁵ *Id.* at 10-12.

⁶⁶ *Id.* at 13.

⁶⁷ *Id.* at 14.

those of its parent.⁶⁸ DETI points out that these certificate and rate proceedings, by their nature, involved Commission review of initial or new proposed rates, so they contain no discussion about obtaining a “waiver” from the Commission and do not state that a “waiver” is required for a pipeline to use the capital structure or book balances of a parent entity that provides its financing. According to DETI, “[n]one of those cases provide support for Audit Staff’s purported ‘waiver’ requirement.”⁶⁹ DETI disputes audit staff’s interpretation of the Commission statement found in some certificate and rate cases that “it is Commission policy to use a pipeline’s own capital structure.” DETI claims that if the pipeline does not provide its own financing, the Commission’s policy is to use the “capital structure” of the entity that does provide the financing.⁷⁰ DETI rejects audit staff’s assertion that Commission policy regarding capital structure “outlines an analysis to be performed by the Commission....”⁷¹ DETI argues that this language establishes a policy “to use the actual capital structure of the entity that does the financing for the pipeline” that DETI was free to apply with respect to AFUDC without getting any approval or waiver from the Commission, that “[t]his is precisely how DETI computed AFUDC since 1986,” and that “the Commission has long been aware of DETI’s method of computing AFUDC....”⁷²

30. DETI argues that audit staff’s position is a modification of Commission policy without support or explanation.⁷³ Further, DETI contends that the waiver recently granted to its affiliate, Dominion Cove Point LNG, LP, authorized the affiliate to disregard its own book balances and use its parent company’s CWIP book balance, exactly as DETI has done. This disproves, DETI asserts, audit staff’s claim that the Commission has never granted a waiver permitting a pipeline to disregard its own short-term debt and CWIP balances and to derive AFUDC from the book balances of its

⁶⁸ DETI Reply Memorandum at 5-7; *see* Audit Staff Initial Memorandum at 12-13.

⁶⁹ DETI Reply Memorandum at 7.

⁷⁰ *Id.* at 5 (quoting *Entrega Gas Pipeline, Inc.*, 112 FERC ¶ 61,177 at P 47 (“If the pipeline does not provide its own financing, the Commission looks to another entity. The Commission policy in this regard is to use the actual capital structure of the entity that does the financing for the regulated pipeline”)).

⁷¹ *Id.* at 5.

⁷² *Id.* at 6.

⁷³ *Id.* at 9 (“[t]he Commission may not modify its policies without sufficient explanation” or without “notice of such changes”).

parent.⁷⁴ DETI also argues that it has demonstrated that “use of its parent company’s capital structure most accurately reflects its cost of obtaining capital” and is also therefore “the most accurate reflection of DETI’s cost of financing its construction projects.”⁷⁵

Audit Staff Reply Memorandum

31. In its reply memorandum, audit staff states that the Commission’s policy and precedent do not require or authorize DETI, of its own accord, to exclude its own book balances and apply those of its parent in its AFUDC rate calculation, particularly with respect to CWIP and short-term debt book balances.⁷⁶ As an initial matter, audit staff contends that “[t]hroughout DETI’s argument DETI conflates the two terms [capital structure and book balances] for its benefit [yet] the differences are significant.”⁷⁷ Audit staff maintains that “capital structure” is generally used in ratemaking and Commission precedent to refer to permanent, long-term financing, “including long-term debt, preferred stock, and common stock. It does not include construction work in progress. It also typically does not include short-term debt because of its [short-term debt’s]

⁷⁴ *Id.* at 9-10.

⁷⁵ *Id.* at 10-11.

⁷⁶ Audit Staff Reply Memorandum at 7.

⁷⁷ *Id.* at 7.

temporary and variable nature.”⁷⁸ Audit staff maintains that DETI improperly treats Commission precedent pertaining to “capital structure” as precedent authorizing use of a parent’s “consolidated book balances.” Audit staff asserts that “DETI’s general assertion that ... Commission policy and precedent required it to use the consolidated book balances of its parent company is patently false and distinguishable from the support DETI provides related to the Commission’s approval of a parent company’s capital structure”⁷⁹

32. According to audit staff, DETI erroneously contends that Commission policy and precedent “required” it to not use its own short-term debt and CWIP balances, and DETI misconstrues Commission cases by conflating the separate concepts of “capital structure” and “book balances.” Audit staff contends that DETI relies on cases about determining “capital structure” in the context of a rate proceeding, not cases about the appropriateness of using a parent entity’s consolidated book balances for AFUDC purposes. Audit staff further asserts that even in the orders relied on by DETI regarding “capital structure” in rate proceedings, the Commission lays out multiple alternatives that the Commission itself, considers and from which the Commission selects a method to determine an appropriate capital structure. Audit staff therefore concludes that: “It is not reasonable for DETI to assume that the Commission required it to automatically use its parent company’s book balances given the various ways an appropriate capital structure can be determined.”⁸⁰ Audit staff maintains that the policy and precedent relied on by DETI actually supports audit staff’s position that DETI was not authorized to use the consolidated book balances of its parent in determining AFUDC, and that any “such requirement or direction” could only “take[] place after Commission evaluation” of DETI’s specific factual circumstances, in response to a waiver/authorization request submitted by DETI, since DETI’s actions also caused it to exceed the maximum AFUDC rate established by GPI No. 3(17)’s formula applied to DETI’s own book balances.⁸¹

33. Audit staff characterizes DETI’s claim that its affiliate, Dominion Cove Point, obtained a waiver “to compute AFUDC using its parent company’s book balances” as “another example of DETI misinterpretation of Commission policy and precedent.” Audit staff notes that the letter order granting the waiver stated that the affiliate requested “to use the *capital structure* of its parent ... when calculating AFUDC,” not the parent’s

⁷⁸ *Id.* at 11 (citing Order No. 561, 57 FPC 608 at 609, and Order No. 561-A, 59 FPC 1340 at 1342-1343).

⁷⁹ *Id.* at 8.

⁸⁰ *Id.* at 12.

⁸¹ *Id.*

consolidated book balances,⁸² and DETI's affiliate represented that it had no short-term debt on its books, which is not the case here for DETI. Audit staff emphasizes that "DETI did not simply use its parent company's capital structure but rather its parent company's *consolidated book balances, including* [those for] *short-term debt and CWIP.*"⁸³ Audit staff reasserts that: "DETI has provided no support that Commission policy and precedent required it to use its parent company's consolidated book balances for the AFUDC rate components."⁸⁴

D. Other Grounds That DETI Offers For Not Applying GPI No. 3(17)

34. DETI makes the following other claims that it contends support not applying GPI No. 3(17) to DETI: (1) lack of notice and alleged arbitrary departure from existing Commission policy; (2) alleged open and transparent use of DETI's "method" of calculating AFUDC; (3) policy claims for not applying Order No. 561 and GPI No. 3(17) to DETI; and (4) alleged arbitrary, selective enforcement.

1. Lack of Notice and Alleged Arbitrary Departure from Existing Commission Policy

DETI Initial Memorandum

35. DETI asserts that requiring it to use its own book balances when computing AFUDC would be arbitrary, capricious and a failure of due process.⁸⁵ According to DETI, this would ignore "decades of precedent" that "require[d] that pipelines calculate AFUDC using the book balances of the entity that provide [sic] their financing."⁸⁶ According to DETI, a requirement that DETI compare its own short-term debt balance to its own CWIP balance constitutes a departure from Commission policy and precedent without any reasoned explanation, and hence would be arbitrary and capricious. DETI argues that, at the very least, such a requirement constitutes a modification or clarification of a policy that was unclear, and should only be applied prospectively, after notice.⁸⁷ DETI further asserts that, without receiving warning that the Commission had

⁸² *Id.* at 13 (emphasis is audit staff's).

⁸³ *Id.* (emphasis is audit staff's).

⁸⁴ *Id.*

⁸⁵ DETI Initial Memorandum at 12-20.

⁸⁶ *Id.* at 12-13.

⁸⁷ *Id.* at 13-17.

changed its AFUDC policy, similar for example to that provided in *Southern Star*, DETI had no opportunity to comply before being audited.⁸⁸

36. According to DETI, it “first became aware of Audit Staff’s new position shortly after the issuance of an audit report for Columbia Gas Transmission, LLC (Columbia) on December 30, 2014.”⁸⁹ In that audit report, audit staff found that Columbia had used an AFUDC rate based on an aggregate of several of its affiliates’ book balances without having sought authorization, and that it should have obtained authorization from the Commission to use this methodology. DETI states that “[t]he Commission did not, in approving the Columbia audit report or in any order since, *announce a generally applicable policy that pipelines must obtain a waiver to compute AFUDC using book balances other than their own.*”⁹⁰ According to DETI, audit staff is applying a new policy without acknowledging a departure from clearly established prior policy, and without explaining such departure. Alternatively, DETI states that this could be described as a situation in which the Commission believed its policy was clear, but industry-wide compliance has been inadequate due to a misunderstanding of that policy, and the Commission should provide the industry with notice by articulating its policy in a new order and instructing the industry to comply prospectively.⁹¹

DETI Reply Memorandum

37. DETI repeats this claim, arguing that audit staff is seeking to change Commission policy without advance notice. DETI contends that, “[w]ithout notice and without citing to any precedent, Audit Staff asserts that a waiver is required for a pipeline that is financed by its parent company to compute AFUDC using the parent company’s book balances.”⁹² DETI states that the Commission may not modify its policies without

⁸⁸ *Id.* at 14-16 (citing *S. Star Cent. Gas Pipeline, Inc.*, 125 FERC ¶ 61,082 (2008) (*Southern Star*)).

⁸⁹ *Id.* at 13 and n.44 (referencing *Columbia Gas Transmission, LLC*, Docket No. FA13-5-000, Audit Report at 31-36, (Dec. 30, 2014) (delegated order); see DETI Reply Memorandum at 1-2 (again stating that DETI did not become aware of alleged “new position” until issuance of audit report to Columbia Gas Transmission, LLC in December 2014)).

⁹⁰ *Id.* at 14 (emphasis added).

⁹¹ *Id.* at 14-16.

⁹² DETI Reply Memorandum at 9.

sufficient explanation and advance notice, and concludes that “[a] change in policy without providing notice is arbitrary, capricious and a violation of due process.”⁹³

Audit Staff Reply Memorandum

38. Audit staff rejects DETI’s claims that it is creating a new policy and acting arbitrarily. Audit staff contends that its finding and recommendations are consistent with the requirements of GPI No. 3(17) and supported by more than thirty years of Commission orders, including the very orders DETI relies on.⁹⁴ Audit staff asserts that “DETI erroneously claims that ... Commission regulations, orders, and its policy and precedent creates an automatic requirement that DETI must use the book balances of its parent company under the premise that the parent provides its financing.”⁹⁵ Audit staff further argues that the cases DETI relies on actually demonstrate that the Commission reviewed and analyzed requests to use a parent company’s capital structure (or book balances) on a case-by-case basis because the Commission’s policy requires a pipeline to use its own book balances. Audit staff concludes that: “The policy and precedent that DETI puts forth is vastly misinterpreted [by DETI] and generally supports Audit Staff’s positions.”⁹⁶

2. Alleged Open and Transparent Use of DETI’s “Method” of Calculating AFUDC

DETI Initial Memorandum

39. DETI claims that it has been transparently using its method of calculating an AFUDC rate, using the “book balances” of its parent for over three decades, during which DETI was the subject of one audit by Commission audit staff and four general rate cases, without the Commission objecting.⁹⁷ DETI states in an affidavit that its FERC Form No. 2 reports “would have been the subject of review by FERC Staff during these general rate cases and during [DETI’s] prior audit,”⁹⁸ and that DETI’s AFUDC method

⁹³ *Id.* (footnote and citations omitted).

⁹⁴ Audit Staff Reply Memorandum at 16.

⁹⁵ *Id.* at 5 (citing DETI Initial Memorandum at 3-4).

⁹⁶ *Id.*

⁹⁷ DETI Initial Memorandum at 2, 7, 16-17.

⁹⁸ Stevens Affidavit at 3 (Exh. DETI-2).

was revealed in its annual FERC Form No. 2 filings.⁹⁹ DETI asserts that “because DETI’s methodology was transparent for 30 years, DETI had good reason to believe it was complying with Commission precedent and policy,” and therefore “it is unfair and a violation of due process to now punish DETI for alleged noncompliance with this policy.”¹⁰⁰ DETI also argues that its apparent violation based on activity that the Commission or its staff has, in DETI’s view, condoned for 30 years is not due to DETI’s actions, but rather due to an unexplained, capricious rejection of longstanding Commission precedent.¹⁰¹

DETI Reply Memorandum

40. In its reply memorandum, DETI again asserts that its practices with respect to AFUDC have been transparent for many years. DETI maintains that “the Commission has long been aware of DETI’s method of computing AFUDC through its [DETI’s] annual Form [No.] 2 filings, a past audit of its accounting practices, and several rate proceedings.”¹⁰² DETI contends that it has “transparently computed AFUDC using its parent company’s book balances for over 30 years”¹⁰³

⁹⁹ DETI Initial Memorandum at 7 (claiming that “DETI has always been transparent regarding [its] methodology [of calculating AFUDC] and disclosed it in its [DETI’s] FERC Form 2 reports”); Stevens Affidavit (Exh. No. DETI-2) at 3 (“This methodology has always been transparent and disclosed in the company’s FERC Form 2 Reporting”).

¹⁰⁰ *Id.* at 17.

¹⁰¹ *Id.* at 12-13.

¹⁰² DETI Reply Memorandum at 6 (footnote and citations omitted).

¹⁰³ *Id.*

3. **Policy Claims For Not Applying Order No. 561 and GPI No. 3(17) to DETI**
 - a. **Tracing Specific Sources of Capital DETI Used for AFUDC**

DETI Initial Memorandum

41. DETI argues that its own capital structure does not reflect the true cost of the financing it receives, and thus requiring it to use its own short-term debt balance and short-term debt cost when computing AFUDC would lead to inaccurate, arbitrary results.¹⁰⁴ DETI acknowledges that the debt contribution funds DETI received from its parent were delivered through an intercompany borrowing arrangement.¹⁰⁵ DETI further states that its parent, Dominion, flowed funds to DETI to provide funds needed for construction and operations not funded out of DETI's current revenues and that all funds were passed to DETI from Dominion as "short-term" financing.¹⁰⁶

DETI Reply Memorandum

42. In its reply, DETI again argues that it has demonstrated that "use of its parent company's capital structure most accurately reflects its cost of obtaining capital" and is also therefore "the most accurate reflection of DETI's cost of financing its construction projects."¹⁰⁷

Audit Staff Reply Memorandum

43. In its reply, audit staff argues that DETI's use of its parent's consolidated CWIP and short-term debt balances results in an AFUDC rate that does not reflect the actual costs of DETI's construction program.¹⁰⁸ Audit staff points to the finding of its witness that the consolidated CWIP balance of DETI's parent included construction costs from DETI subsidiaries and affiliates that DETI, itself, did not incur, and concludes that a

¹⁰⁴ DETI Initial Memorandum at 10.

¹⁰⁵ *Id.* at 9.

¹⁰⁶ *Id.* at 10.

¹⁰⁷ DETI Reply Memorandum at 10-11.

¹⁰⁸ *See* Audit Staff Reply Memorandum at 14-15.

comparison of the consolidated CWIP and short-term debt balances does not result in an AFUDC rate reflecting the actual costs of DETI's construction program.¹⁰⁹

b. **DETI's Concern About Pipelines With 100% Equity Financing**

DETI Initial Memorandum

44. DETI asserts that for companies that are wholly equity-financed by their parent, requiring them to apply their own book balances would result in artificially high rates – i.e., an AFUDC rate equal to the cost rate for common equity.¹¹⁰

Audit Staff Reply Memorandum

45. Audit staff rejects DETI's concern that requiring pipelines to use their own book balances would result in some pipelines computing AFUDC on a 100 percent equity basis. Audit staff notes that the Commission has a "clearly articulated" policy that prohibits a pipeline with 100 percent equity financing from basing AFUDC on such financing and, instead, requires such pipeline to use the approved rate of return from the pipeline's last rate proceeding, which itself is required to be based on the parent entity's "capital structure" consisting not just of equity but also long-term debt.¹¹¹

c. **DETI's Claim of an "Inconsistent Computation"**

DETI's Reply Memorandum

46. DETI argues in its reply memorandum that using a pipeline's own short-term debt and CWIP balances in the AFUDC formula but applying cost rates derived from its parent entity's costs to value the pipeline's preferred stock, long-term debt and equity book balances "results in an inconsistent computation."¹¹² DETI asserts that "once it is determined that the parent company's capital structure is to be used, all of that entity's book balances must be used, including the CWIP."¹¹³

¹⁰⁹ *Id.* (quoting Strohmeier Initial Testimony at 10-11).

¹¹⁰ DETI Initial Memorandum at 12.

¹¹¹ Audit Staff Reply Memorandum at 15.

¹¹² DETI Reply Memorandum at 8.

¹¹³ *Id.* at 9.

4. Alleged Arbitrary, Selective Enforcement

DETI Initial Memorandum

47. DETI argues that requiring it to adjust its gas plant accounts to reflect lower amounts of AFUDC based on staff's position that DETI exceeded the maximum AFUDC rate would be arbitrary and unfair because staff's position allegedly is a "new policy" that has not been, and is not being, applied uniformly to other regulated natural gas pipelines. DETI acknowledges that in a 2014 uncontested audit report regarding a different pipeline, audit staff applied this "new policy." But, DETI also asserts that a review of 83 regulated natural gas pipelines' 2016 FERC Form No. 2s indicates that "[n]early one-third" are "using book balances other than their own" and yet had not sought waivers to do so.¹¹⁴ DETI asserts that, except for the one 2014 delegated order, audit staff has not applied its new policy in audits of "other companies that do not compute AFUDC using their own capital structures,"¹¹⁵ and that in 2015, audit staff examined the AFUDC calculations of a pipeline company that "used its parent company's capital structure" and did not find fault with it.¹¹⁶ DETI's expert witness avers that numerous other pipelines are using capital structures or capital cost rates of parent entities in their computation of AFUDC without having requested or received a waiver.¹¹⁷ DETI asserts that the fact that its two affiliates applied for waivers of GPI No. 3(17) and received them indicates that, substantively, its practice of computing AFUDC using its parent company's consolidated book balances is appropriate.¹¹⁸ According to DETI, it is being selectively penalized for not complying with a change in regulatory interpretation that has not been clearly announced.¹¹⁹

¹¹⁴ DETI Initial Memorandum at 17.

¹¹⁵ *Id.* at 17.

¹¹⁶ *Id.* at 17-18 (citing *Natural Gas Pipeline of America, LLC*, Docket No. PA13-5-000 (Oct. 30, 2015) (delegated order)).

¹¹⁷ *Id.* at 17 (citing Guest Affidavit, Exh. No. DETI-3 at 5:12-21 and Exh. No. JKG-3).

¹¹⁸ *Id.* at 19.

¹¹⁹ *Id.*

Audit Staff Reply Memorandum

48. Audit staff asserts that DETI's evidence that there are pipelines using their parent's "capital structure" in calculating AFUDC without having obtained a Commission waiver is not indicative of arbitrary or discriminatory enforcement, or of a new policy. Audit staff notes that the AFUDC regulations do not prescribe a specific methodology – that is, "the regulations do not require utilities to record AFUDC at the maximum allowable rate....Commission prior approval is only required for methods that cause the rate to exceed the maximum rate [that would be calculated] using the formula in GPI No. 3(17)."¹²⁰ Audit staff further states that "no finding [of non-compliance] would be taken if the rate using the parent's capital structure or some other method were used and it did not cause the [AFUDC] rates to be excessive in comparison to [the AFUDC rate produced by] the GPI No. 3(17) methodology."¹²¹ In short, according to audit staff, DETI mistakenly treats GPI No. 3(17) as prescribing a methodology, when it does not, and instead prescribes a maximum AFUDC rate calculated using its formula.

E. Whether the Audit Report's Recommendation That DETI Restate Its Account Balances Prospectively Based On Recalculating Its AFUDC In Accordance With GPI No. 3(17) From 2008 to the Present Is "Fundamentally Unfair"

DETI Initial Memorandum

49. DETI objects to correcting its account balances with respect to accounting entries found to be incorrect and contrary to Commission regulations if DETI first made the inappropriate entries before January 1, 2012. DETI objects that correcting these inappropriate entries would be "fundamentally unfair." The Audit Report recommends that, for use on a going forward basis, DETI's account balances should be corrected by having DETI recalculate its AFUDC balances and other balances affected by its improper AFUDC entries, starting in 2008. Specifically, the Audit Report recommends recalculating those balances from 2008 to the present using the maximum AFUDC rate determined by GPI No. 3(17)'s formula, rather than the AFUDC rates in excess of that maximum, and then applying the resulting corrected account balances going forward, i.e., on a prospective basis only. DETI objects to starting such corrections in 2008, asserting

¹²⁰ Audit Staff Reply Memorandum at 17.

¹²¹ *Id.* at 17-18 and n.44 (citing *CenterPoint Energy Gas Transmission Co.*, 119 FERC ¶ 61,138, at P 24 (2007)); see *CenterPoint Energy*, 119 FERC ¶ 61,138 at P 24 ("CEGT may elect to utilize its proposed AFUDC rate provided that it is less than the maximum rate determined under the formula prescribed").

it would be “fundamentally unfair” for such corrections to start any earlier than January 1, 2012.¹²²

50. DETI notes that the audit commencement letter, dated April 15, 2015, and sent to DETI by audit staff, stated that “[t]he audit will cover January 1, 2012 through the present.”¹²³ DETI also notes that descriptions of the audit process provided by the Commission’s Office of Enforcement and found on the Commission’s website state that the audit commencement letter defines the “scope” of the audit.¹²⁴ According to DETI, the audit commencement letter “provided no reason for either DETI or the public to believe that the Commission could order changes to DETI’s books and records for a period outside the audit’s specified scope.”¹²⁵ DETI asserts that to permit any recommended accounting adjustment that arises from the stated review of its records from January 1, 2012 to the present to be put into effect prior to January 1, 2012 would be fundamentally unfair.

51. DETI puts forth three grounds. It asserts that DETI would be “unfairly prejudiced” by any requirement arising from the audit that “it revise its books prior to January 1, 2012.”¹²⁶ Second, DETI notes that it is a publicly-traded company and, in this regard, asserts that “adequate notification of the scope of an audit is critical to regulated pipelines and the investing public,” and that “[a] sudden, unexpected reduction to the company’s gas plant balance *beyond what was already noticed* can harm the company’s public image and valuation in a way that foreseen changes cannot.”¹²⁷ Finally, DETI asserts that sometime after issuance of its audit commencement letter, audit staff began to insert in audit commencement letters a phrase expressly reserving audit staff’s right to expand the audit period if necessary and noting that “recommendations for corrective

¹²² DETI Initial Memorandum at 20.

¹²³ *Id.* at 20 (quoting Letter from Larry D. Gasteiger, Acting Director of Enforcement to Mabelle F. Grim, Director, Gas Regulations, Dominion Resources Services, Inc. (Apr. 15, 2015)).

¹²⁴ *Id.* (citing FERC Office of Enforcement, Audit Process, at 2 (revised Sept. 9, 2014), <http://www.ferc.gov/enforcement/audits/audit-process.pdf>; FERC Office of Enforcement, *How Audits are Conducted*, (updated Jan. 9, 2018), <https://www.ferc.gov/enforcement/audits/conducted.asp>).

¹²⁵ *Id.*

¹²⁶ *Id.* at 21.

¹²⁷ *Id.* (emphasis added).

actions may also cover preceding years.”¹²⁸ DETI asserts that the addition of this new phrase reflects audit staff’s awareness of the fundamental unfairness of recommending a corrective action that takes effect prior to the audit period stated in an audit commencement letter without notice in the audit commencement letter itself that such an outcome might be possible.

Audit Staff Initial Memorandum

52. Audit staff asserts that the Audit Report correctly found that DETI over-accrued AFUDC, by violating the maximum AFUDC rate resulting from GPI No. 3(17)’s formula.¹²⁹ Audit staff states that the Audit Report shows DETI’s accounting practices for AFUDC resulted in inflated balances and contends that the Commission has stated that jurisdictional entities that employ improper accounting are not entitled to reap the benefits of that improper accounting in rates.¹³⁰ Audit staff asserts that, pursuant to Commission regulations, DETI has the burden of proof to justify keeping such amounts in its FERC Form No. 2,¹³¹ and DETI has failed to provide any information that supports keeping such “over-accrued amounts in its FERC Form No. 2; it has failed to meet its burden of proof, and must remove these amounts.”¹³²

Audit Staff Reply Memorandum

53. Audit staff contends that its recommendation that DETI correct its AFUDC accounting mistakes back to 2008 is the appropriate remedy to cure DETI’s non-compliance with the Commission’s accounting regulations. Audit staff maintains that it is not “unfair” to require corrective action back to 2008, that is, prior to the start of the “audit period” referenced in the audit commencement letter issued to DETI. Audit staff notes that under NGA section 8(b), the Commission shall at all times have access to and the right to inspect and examine all accounts, records, and memoranda of natural gas companies.¹³³ According to audit staff, “DETI had sufficient notice” that corrective

¹²⁸ *Id.* at 20-21.

¹²⁹ Audit Staff Initial Memorandum at 15 (citing Audit Report at 25-26).

¹³⁰ *Id.* at 16 (citing *ITC Holdings Corp.*, 139 FERC ¶ 61,112, at P 63 (2012)).

¹³¹ See 18 C.F.R. § 158.8 (2020) (in contested audit proceeding, “burden of proof to justify every accounting entry shall be on the person making, authorizing, or requiring such entry”).

¹³² Audit Staff Initial Memorandum at 16.

¹³³ Audit Staff Reply Memorandum at 18.

actions could be required for years prior to the audit period, and indeed “if instances of noncompliance are identified [during an audit,] it is not unreasonable or surprising that additional examination or corrective action maybe [sic] warranted.”¹³⁴ This is especially true because “audits are not investigations;” they are often commenced without information regarding any specific wrongdoing and are intended “to help the entity maintain or achieve compliance;” if noncompliance is discovered, the scope of review may be expanded “to determine the root cause of the issues, how long they may have been incorrect, and the impact of such.”¹³⁵

F. Whether The Requirement to Correct AFUDC Accounting Balances Since 2008 Is Barred By the General Federal Statute of Limitations

DETI Initial Memorandum

54. Finally, DETI argues that even if its approach to calculating AFUDC were unlawful or improper, requiring DETI to restate AFUDC correctly in its accounting balances starting in 2008 is barred by the federal five-year statute of limitations applicable to penalties and forfeitures.¹³⁶ DETI argues that the Supreme Court has applied the statute of limitations in *Kokesh* even when a federal agency did not consider its actions to constitute a penalty; the Supreme Court applied the statute of limitations to any attempt to redress a wrong and to deter as opposed to compensate.¹³⁷ DETI argues that the requirement that it restate its accounting balances is a “penalty” or a “forfeiture.” DETI asserts that this requirement is for the purpose of deterrence, not compensation to injured persons, that it is punitive, and that it does more than simply return DETI to the position it would be in had no regulatory violation occurred.¹³⁸ DETI asserts that correcting its AFUDC balances as required in the Audit Report would “strip DETI of its right to recover and earn a return on funds it has invested in the regulated facilities” and that it would lose “an opportunity to earn a reasonable return on its investment.”¹³⁹ Because the proposed account balance corrections are allegedly a “penalty” and

¹³⁴ *Id.*

¹³⁵ *Id.* at 19.

¹³⁶ DETI Initial Memorandum at 21-26.

¹³⁷ *Id.* at 22 (citing *Kokesh v. SEC*, 137 S.Ct. 1635 (2017) (*Kokesh*)).

¹³⁸ *Id.* at 21-26.

¹³⁹ *Id.* at 26.

“forfeiture,” DETI argues that the Commission may not require the correction of accounting errors “more than five-years from the date of their recordation.”¹⁴⁰

Audit Staff Initial Memorandum

55. Audit staff asserts that the Audit Report’s recommendations to correct DETI’s accounting errors are not subject to the federal five-year statute of limitations, and the recommendation that DETI recalculate and revise its accounting entries back to 2008 is the appropriate remedy to cure DETI’s noncompliance with the Commission’s accounting regulations.¹⁴¹ Audit staff notes that section 2462 is a five-year statute of limitation applicable to any “action, suit, or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise.”¹⁴² Further, audit staff notes that in *Gabelli v. SEC*, the Supreme Court held that “penalties” under 28 U.S.C. § 2426 “go beyond compensation, are intended to punish, and label defendants wrongdoers,”¹⁴³ and the Supreme Court clarified in *Kokesh* that “a pecuniary sanction operates as a penalty only if it is sought ‘for the purpose of punishment, and to deter others from offending in like manner’—as opposed to compensating a victim for his loss.”¹⁴⁴

56. Audit staff contends that the Audit Report’s recommended corrections do not amount to fines, penalties, or forfeitures under section 2462 and are not punitive, nor do they even rise to the level of compensatory.¹⁴⁵ Audit staff asserts that the Audit Report’s recommendations “simply seek to avoid a *future* injury to DETI’s customers by correcting an error identified in the Audit Report before DETI improperly collects

¹⁴⁰ *Id.*

¹⁴¹ Audit Staff Initial Memorandum at 16-18.

¹⁴² *Id.* at 17 (quoting 28 U.S.C. § 2462 (2012)).

¹⁴³ *Id.* at 17, n.34 (quoting *Gabelli v. SEC*, 568 U.S. 442, 451-52 (2013), and *Meeker v. Lehigh Valley R. Co.*, 236 U.S. 412, 423 (1915) (defining “penalty or forfeiture” in the predecessor statute to § 2426 as “something imposed in a punitive way for an infraction of a public law, and do not include a liability imposed solely for the purpose of redressing a private injury, even though the wrongful act be a public offense, and punishable as such”)).

¹⁴⁴ *Id.* at 17 (quoting *Kokesh*, 137 S.Ct. at 1642 (citing *Huntington v. Attrill*, 146 U.S. 657, 668 (1892))).

¹⁴⁵ *Id.*

erroneously inflated amounts from its customers in a *future* rate case.”¹⁴⁶ Audit staff asserts Commission precedent holds that jurisdictional entities that employ improper accounting practices are not entitled to the benefits of that improper accounting.¹⁴⁷ Audit staff further states: “Stopping DETI from earning a future return on or recovering costs based on inaccurate calculations in no way amounts to a penalty or a forfeiture. To the contrary, to let DETI proceed without correcting its erroneous balances would impose a future penalty on DETI’s customers.”¹⁴⁸

DETI Reply Memorandum

57. DETI contends in its reply that audit staff has failed to show why the federal five-year statute of limitations does not apply and bar audit staff’s proposed remedy of DETI removing on a prospective basis from its plant in-service account amounts that audit staff finds DETI unlawfully recorded in that account “as much as ten years ago.”¹⁴⁹ With respect to audit staff’s assertion that its remedy only applies to future periods, DETI states that audit staff “has not explained why a monetary loss that would occur in the future cannot be a penalty” and that the term “penalty” does not “distinguish between punishments that will harm an entity in the present vs. the future.”¹⁵⁰ DETI also reiterates its argument that audit staff’s remedy is a “penalty” because “it is (1) imposed to redress a wrong committed onto the public, as opposed to an individual, and (2) ... is punitive or is made ‘for the purpose of punishment’ and to deter, ‘as opposed to compensating a victim for his loss.’”¹⁵¹ According to DETI, the punitive nature of audit staff’s actions is revealed by audit staff’s “attempt to side-step clear Commission policy,” and DETI’s belief that audit staff has “fail[ed] to find a regulation or policy that DETI has violated” and instead has “focus[ed] on the company’s alleged failure to obtain its approval,” thereby “seeking to punish DETI for declining to ask for the Commission’s permission and to deter other companies from doing the same.”¹⁵²

¹⁴⁶ *Id.* at 18 (emphasis in original).

¹⁴⁷ *Id.* (citing *ITC Holdings Corp.*, 139 FERC ¶ 61,112 at P 63).

¹⁴⁸ *Id.*

¹⁴⁹ DETI Reply Memorandum at 12.

¹⁵⁰ *Id.*

¹⁵¹ *Id.* (quoting *Kokesh*, 137 S.Ct. at 1641, and citing DETI Initial Memorandum at 23).

¹⁵² *Id.* at 13-14.

Audit Staff Reply Memorandum

58. Audit staff disputes DETI's claim that the federal five-year statute of limitations applies to audit staff's recommended corrective action. Audit staff contends that based on the distinction between punitive and remedial measures made in *Kokesh v. SEC*,¹⁵³ its proposed corrective actions are remedial and "cannot be seen as punitive in nature, nor do they even rise to the level of compensatory in nature."¹⁵⁴ Accounting staff notes first that its proposed corrective actions are not prescribed to redress a wrong against the United States, "but to prevent DETI from collecting an improper future rate of return from its ratepayers," who are "specific individuals."¹⁵⁵ Audit staff asserts that: "A recommendation by Audit Staff to prevent a sustained violation of Commission regulations causing harm to an entity's ratepayers is in no way punitive, and nothing in *Kokesh* or its progeny requires the Commission to characterize it as such."¹⁵⁶ Second, audit staff maintains that DETI's claim that the recommendations are punitive because DETI would "lose the ability to recover or earn a return on the funds invested"¹⁵⁷ are "unavailing" because "Commission precedent holds that jurisdictional entities that employ improper accounting are not entitled to reap the benefits of that improper accounting."¹⁵⁸ According to audit staff, "DETI has incorrectly calculated its AFUDC and overstated its plant balances. DETI may not charge its ratepayers based on those inflated calculations simply because it had the expectation of receiving a return of or on its investment based on those improper calculations."¹⁵⁹

59. In response to DETI's claim that the proposed corrective actions must be punitive because they do not require DETI to "repay any individuals for losses" or "pay out any specific fines,"¹⁶⁰ audit staff states that DETI is correct that it is not being required to repay individuals whom DETI may have already harmed in the past with rates impacted by its improper accounting. The corrective actions are forward looking and "seek to

¹⁵³ Audit Staff Reply Memorandum at 20 (citing *Kokesh*, 137 S.Ct. at 1642-43).

¹⁵⁴ *Id.* at 21.

¹⁵⁵ *Id.*

¹⁵⁶ *Id.* at 22 (footnote and citations omitted).

¹⁵⁷ *Id.* (citing DETI Initial Memorandum at 25).

¹⁵⁸ *Id.* (citing *ITC Holdings Corp.*, 139 FERC ¶ 61,112 at P 63).

¹⁵⁹ *Id.* at 22-23.

¹⁶⁰ *Id.* at 23 (quoting DETI Initial Memorandum at 25).

correct DETI's noncompliance before compensation of any individual ratepayers is even necessary."¹⁶¹ Audit staff thus distinguishes the present case from that in *Kokesh*, where fines for past conduct had been imposed that exceeded the amount necessary to compensate victims, rendering the fines punitive. In the present case, "the fact that Audit Staff's recommendations here do not even require DETI to 'repay' or 'pay out' works against DETI's claim. They are non-compensatory because they *do not rise to the level of compensation*, not because [as in *Kokesh*] they go beyond compensation."¹⁶²

60. Finally, audit staff rejects DETI's claim that the corrective actions constitute a forfeiture, which claim, audit staff asserts, is based on DETI's assertion that it would be stripped of its right to recover and earn a return on its investment. DETI's argument rests "on the erroneous assumption that it has the right to recover and earn a return based on its current, improper AFUDC rate calculations... [But] DETI has exceeded its maximum allowable AFUDC rate, without prior Commission approval ... Therefore, because DETI has not complied with Commission regulations, it never established a right to earn a return based on its current, improper AFUDC rate calculation."¹⁶³ Audit staff concludes that "[t]he proper measure of DETI's investment in plant is the adjusted amounts remaining in plant after excess AFUDC is removed."¹⁶⁴ In addition, audit staff points out that DETI's claim is factually incorrect: "None of their [i.e., DETI's] actual investment is lost through Audit Staff's recommended corrective actions ..."¹⁶⁵

V. Discussion

61. As discussed in greater detail below, and following review of the Initial and Reply Memoranda, we find that DETI's calculation of AFUDC is not consistent with the Commission's accounting regulations and uphold the contested finding and challenged recommendations in the Audit Report. In this proceeding, it is undisputed that from 2008 to the present period covered by the Audit Report, DETI's short-term debt balances exceeded DETI's CWIP balances. Per the regulations in GPI No. 3(17)(b), DETI should have calculated its AFUDC rate using only weighted average short-term debt rates.¹⁶⁶

¹⁶¹ Audit Staff Reply Memorandum at 23.

¹⁶² *Id.*

¹⁶³ *Id.* at 24.

¹⁶⁴ *Id.*

¹⁶⁵ *Id.*

¹⁶⁶ See, e.g., *Tennessee Gas Pipeline Co.*, 64 FERC ¶ 61,340, at 63,442 (1993) ("In cases such as Tennessee's, where the amount of short-term debt exceeds the amount

However, DETI instead used the consolidated balances for short-term debt and CWIP maintained by its parent entity. DETI determined that, for these consolidated balances,¹⁶⁷ the consolidated CWIP monthly balances exceeded consolidated short-term debt, and thus DETI applied cost rates for long-term debt, preferred stock and common equity to a portion of its CWIP to arrive at an AFUDC rate. The AFUDC rate, determined by DETI, was above the AFUDC rate allowed under the Commission's regulations, leading to over capitalization of AFUDC, from 2008 through 2015, by approximately \$54.1 million in audit staff's estimation (although DETI estimates the impact on its plant-in-service account balances from audit staff's proposed accounting corrections to be "approximately \$48 million").¹⁶⁸

62. For the reasons discussed below, we conclude that nothing in the text of the Commission's regulations found at GPI No. 3(17), or in Order No. 561, authorized DETI to exclude the fact that its book balances of short-term debt exceeded its book balances of CWIP. Therefore, per GPI No. 3(17), DETI's AFUDC rate should have been calculated without reference to cost rates for long-term debt, preferred stock or common equity. The amount of AFUDC calculated by DETI exceeded the maximum amount prescribed by the AFUDC formula, yet at no time did DETI seek authorization from the Commission, as required by GPI No. 3(17), to exceed that maximum amount. As the Commission held in another proceeding in which a regulated entity, without seeking Commission authorization, excluded its short-term debt balances from its AFUDC rate calculation: "[O]ur regulations are clear and explicit that short-term debt should be included in the calculation of AFUDC rates It was and is [the regulated entity's] obligation to justify a departure, i.e., a waiver of those regulations and that policy, and [it] did not and has not done so."¹⁶⁹

A. Whether GPI No. 3(17) Is Vague and Authorizes DETI's Actions

63. DETI argues that the text of GPI No. 3(17) is vague, but the regulation is best interpreted as directing a regulated natural gas company that receives most or all of its financing from another entity to use the accounting book balances and cost rates of that

of CWIP, the weighted average short-term debt rate is to be used as the maximum AFUDC rate"), *reh'g denied through notice of no action on reh'g request*, 65 FERC ¶ 61,257 (1993).

¹⁶⁷ We note that DETI has not disputed audit staff's assertion that Dominion's consolidated balances covered numerous subsidiaries in addition to DETI, including entities not subject to the Commission's jurisdiction.

¹⁶⁸ September 27, 2017 Response at 6, n.9.

¹⁶⁹ *Otter Tail Power Co.*, 119 FERC ¶ 61,217, at P 15 (2007).

other entity when calculating AFUDC. However, we find that GPI No. 3(17) is not vague and, further, the regulation does not direct a regulated utility to use the book balances or cost rates of any entity other than the regulated entity, itself, in GPI No. 3(17)'s formula for determining the maximum AFUDC rate.

64. As noted in the preceding regulatory framework discussion, Part 201 of the Commission's regulations consists of the Uniform System of Accounts Prescribed for Natural Gas Companies Subject to the Provisions of the Natural Gas Act. Part 201 establishes and gives instructions pertaining to accounts that are to be maintained by the entities subject to the Commission's jurisdiction under the Natural Gas Act, not how another entity, such as a parent entity (unless specified otherwise) is required to maintain accounts.¹⁷⁰ The Gas Plant Instructions (GPI) set out in Part 201 are instructions for "[t]he detailed gas plant accounts (301 to 309, inclusive)" which "*shall be stated on the basis of cost to the utility of plant constructed by it ...*"¹⁷¹ GPI No. 3(17) must be read in the context of GPI No. 3, as a whole, which pertains to "the cost of construction properly includable in the gas plant accounts" of the regulated utility,¹⁷² which accounts are to be "stated on the basis of cost to the utility."¹⁷³ Subsection 17 of GPI No. 3 pertains to calculation of the AFUDC component of construction costs, and states that it is intended to include the "net cost for the period of construction of borrowed funds used for construction ... and a reasonable rate on other funds when so used, not to exceed without prior approval of the Commission" the formula found in GPI No. 3(17)(a).¹⁷⁴ The instruction also states that "[t]he balances for long-term debt, preferred stock and common equity shall be the actual book balances as of the end of the prior year."¹⁷⁵

65. Given that the focus of Part 201 is to establish the accounts of the regulated natural gas company, "on the basis of cost to the utility,"¹⁷⁶ the natural reading of

¹⁷⁰ See, e.g., Part 201, General Instruction No. 1 (2020), which defines "Major" natural gas company and "Nonmajor" natural gas company as a "natural gas company as defined in the Natural Gas Act" and states: "This system applies to both Major and Nonmajor natural gas companies." 18 C.F.R. Part 201, General Instruction No. 1 (2020).

¹⁷¹ GPI No. 1.C (2020) (emphasis added).

¹⁷² GPI No. 3.A (2020).

¹⁷³ GPI No. 1.C (2020).

¹⁷⁴ GPI No. 3(17) (2020).

¹⁷⁵ GPI No. 3(17)(b) (2020).

¹⁷⁶ GPI No. 1.C (2020).

references to book balances in GPI No. 3(17) is that these references are to the book balances of the jurisdictional natural gas company, not those of some other entity. Thus, for example, the instruction that “[t]he balances for long-term debt, preferred stock and common equity shall be the actual book balances as of the end of the previous year,”¹⁷⁷ refers to the “actual book balances” of the regulated natural gas company, not some other entity. The instruction that “[t]he cost rate for common equity shall be the rate granted common equity in the last rate proceeding”¹⁷⁸ refers to the rate granted to the regulated gas utility in its last rate proceeding, not to a common equity cost rate of some other entity. When GPI No. 3(17) prescribes that “[t]he short-term debt balances and related cost and the average balance for construction work in progress shall be estimated for the current year with appropriate adjustments as actual data becomes available,”¹⁷⁹ it is referring to the “short-term debt” and “construction work in progress” balances and the “actual data [that] becomes available” of the regulated natural gas company, not of some other entity.

66. We disagree with DETI’s assertion that GPI No. 3(17) is vague because the regulation “does not specify whether the pipeline should use its own book balances or those of its parent company.”¹⁸⁰ As discussed above GPI No. 3(17) relates to how the regulated entity is to calculate its own “net cost for the period of construction of borrowed funds ... and a reasonable rate on other funds when so used,”¹⁸¹ and is embedded within GPI No. 3, which seeks to establish “the cost of construction properly includable in the gas plant accounts” of the regulated pipeline,¹⁸² and is subject to the Gas Plant Instruction that “gas plant accounts ... shall be stated *on the basis of cost to the utility* of plant constructed by it.”¹⁸³ Therefore, the natural and reasonable reading of GPI No. 3(17) is that its numerous references to “balances” and “book balances” refer to the book balances of the regulated utility, not those of some other entity. Indeed, it would be unnatural, and unnecessary, for the regulations to specify each time that a reference is made to “balances” or “book balances” that the balances being referred to are those of the regulated entity. The applicability of GPI No. 3(17) is not substantially different than

¹⁷⁷ GPI No. 3(17)(b) (2020).

¹⁷⁸ *Id.*

¹⁷⁹ *Id.*

¹⁸⁰ DETI Initial Memorandum at 4.

¹⁸¹ GPI No. 3(17) (2020).

¹⁸² GPI No. 3.A (2020).

¹⁸³ GPI No. 1.C (2020).

many other provisions in Part 201, and if one applies DETI's rationale to GPI No. 3(17) and to other provisions in Part 201, then none of the provisions would be interpreted as requiring information specifically related to the jurisdictional company's costs and revenues. That is not the intent of Part 201.

67. We also disagree with DETI's arguments that the purported vagueness in GPI No. 3(17) is resolved by "explicit guidance" where GPI No. 3(17) refers to Part 154 of the Commission's regulations.¹⁸⁴ Part 154 of the Commission's regulations pertains to the rate schedules and tariffs of regulated entities required to be filed pursuant to section 4 of the NGA. DETI argues that GPI No. 3(17)'s reference to Part 154 was intended to incorporate section 154.312(f) of the Commission's regulations. Specifically, DETI relies on the portion of section 154.312(f) which states:

Statement F-1. Rate of Return claimed. Show the percentage rate of return claimed and the general reasons therefore. Where any component of the capital of the filing company is not primarily obtained through its own financing, but is primarily obtained from a company by which the filing company is controlled, as defined in the Commission's Uniform System of Accounts, then the data required by these statements must be submitted with respect to the debt capital, preferred stock capital, and common stock capital of such controlling company or any intermediate company through which such funds have been secured.¹⁸⁵

68. DETI concludes that "Clearly, GPI No. 3(17) requires a pipeline company to use the book balances of the company that provides its financing, as it instructs pipelines to use the 'actual book balances,' in accordance with subpart D of Part 154. For DETI, this means using its parent company's capital structure."¹⁸⁶

69. We disagree with DETI's assertion that the reference in GPI No. 3(17)(b) to Part 154, subpart D was intended to incorporate section 154.312(f). GPI No. 3(17)(b) states that regulated entities are to calculate the "cost rates for long-term debt and preferred stock" using "weighted average cost determined in the manner indicated in subpart D of part 154." The regulation is specific that it is referencing simply the weighted average cost method of calculating the cost of long-term debt and preferred stock based on prior year data. The manner of doing such weighted average cost calculation for long-term debt is found in section 154.312(h), entitled *Statement F-3*,

¹⁸⁴ DETI Initial Memorandum at 4.

¹⁸⁵ 18 C.F.R. § 154.312(f) (2020); *see* DETI Initial Memorandum at 4.

¹⁸⁶ DETI Initial Memorandum at 5.

which explains how to calculate the “weighted average cost of debt capital” for “each class and series of long-term debt outstanding” as of “the end of [a] 12-month base period of actual experience....”¹⁸⁷ Similarly, the manner of doing such weighted cost calculation for preferred stock is set forth in section 154.312(i),¹⁸⁸ entitled *Statement F-4*, which explains how to calculate the “weighted average cost of preferred stock capital” for “each class and series of preferred stock outstanding” as of “the end of [a] 12-month base period.”¹⁸⁹

70. Further, DETI’s assertion that GPI No. 3(17)(b) “instructs pipelines to use the ‘actual book balances’ in accordance with subpart D of Part 154,”¹⁹⁰ is incorrect. Rather, GPI No. 3(17)(b) instructs regulated natural gas companies to calculate the cost rate associated with their own long-term debt and preferred stock using “weighted average cost determined in the manner indicated in subpart D of part 154.”¹⁹¹ The reference to subpart D makes no mention of “actual book balances.”

71. We find GPI No. 3(17)(b), in reference to Part 154, subpart D, to only reference the method of how to calculate “weighted average cost” from prior year data that regulated natural gas companies are to apply to calculate the “cost rates” to be applied to their own prior year book balances of long-term debt and preferred stock. Nothing in GPI No. 3(17) suggests that short-term debt balances, or any other balances, should be calculated using a parent’s or other entity’s balances.

72. Furthermore, Order No. 561 explained that the balances to be used for long-term debt, preferred stock, and common equity would be the regulated entity’s prior year balances. Specifically, Order No. 561 stated that the “cost rates” would be “the effective weighted average cost of such capital,” and explained that commenters had raised numerous questions regarding whether discounts, premiums, and other expenses would be included in such calculations. To address these questions, Order No. 561 explained that the cost of long-term debt should be calculated as set forth in “Statement F(3)—Debt Capital” in Part 154. By contrast, in this extensive discussion in Order No. 561 of the

¹⁸⁷ 18 C.F.R. § 154.312(h)(1)-(7) (2020).

¹⁸⁸ In Order No. 582, the Commission replaced the requirements of section 154.63(f) of the Commission’s regulations with section 154.312 of the Commission’s regulations. Other provisions of section 154.63 of the Commission’s regulations were redistributed throughout other portions of Part 154.

¹⁸⁹ 18 C.F.R. § 154.312(i)(1)-(9) (2020).

¹⁹⁰ DETI Initial Memorandum at 5.

¹⁹¹ 18 C.F.R., Part 201, GPI No. 3(17)(b) (2020).

account balances to be used and method of calculating weighted average cost using prior year data, there is no mention whatsoever of section 154.312(f) of the Commission's regulations, Statement F-1, or using account balances of any entity other than the regulated utility or natural gas company.¹⁹² There is thus no support for DETI's claims

¹⁹² Order No. 561 states in relevant part (emphasis added):

We are modifying the proposed rule to provide that the balances of long-term debt, preferred stock, and common equity for use in the formula [calculating maximum AFUDC] for the current year will be the balances in such accounts at the end of the prior year; the cost rates for long-term debt and preferred stock will be the effective weighted average cost of such capital. The average short-term debt balances and related cost and the average construction work in progress balance will be estimated for the current year. *We shall require, however, that public utilities and natural gas companies monitor their actual experience and adjust to actual at year-end if a significant deviation from the estimate should occur. For this purpose we shall consider a significant deviation to exist if the gross AFUDC rate exceeds by more than one-quarter of a percentage point (25 basis points) the rate that is derived from the formula by use of actual 13 month balances of construction work in progress and the actual weighted average cost and balances for short-term debt outstanding during the year.*

Many respondents requested clarification as to whether premiums, discounts and expenses related to long-term debt, and compensating balances and commitment fees related to short-term debt, were to be considered when determining the cost rate for such funds. *With respect to long-term debt, the cost of such capital should be the yield to maturity determined in the same manner as set forth in § 35.13(b)(4)(iii), Statement F – Rate of Return, of the Commission's Regulations under the Federal Power Act and § 154.63(f), Statement F(3) – Debt Capital, of the Commission's Regulations under the Natural Gas Act which gives appropriate recognition to premiums, discounts and expenses related to long-term debt...."*

Order No. 561, 57 FPC 608 at 610-11 (emphasis added) (note that "Statement F(3)—

regarding the intent of the reference to Part 154, subpart D in GPI No. 3(17). Moreover, there is no express language supporting DETI's argument that Order No. 561 and GPI No. 3(17) "directs" a regulated entity to determine AFUDC based on the account balances of such parent entity if it obtains funding from the parent entity.

73. We also disagree with DETI's assertions that audit staff has been "internally inconsistent" in interpreting GPI No. 3(17).¹⁹³ DETI asserts that although audit staff concludes that "[n]othing in GPI No. 3(17) directs a company to use book balances other than its own," audit staff inconsistently takes the position that GPI No. 3(17) requires a company to derive the "cost rates for long-term debt and preferred stock in the manner required for a rate case," which DETI asserts is using its parent company's cost rates.¹⁹⁴ However, we find that GPI No. 3(17) both references and intends to borrow and incorporate just the method of calculating a weighted average cost for long-term debt and preferred stock using twelve months of prior year data, and that method is applied to the utility's own prior year costs, not that of its parent entity.¹⁹⁵ This position is consistent with the text of GPI No. 3(17) as well as the discussion in Order Nos. 561 and 561-A, as explained above. Per GPI No. 3(17), that weighted average cost method is applied to the pipeline's own prior twelve months of cost data, not to the parent's cost data. Further, as discussed below, and as audit staff pointed out in its initial memorandum, while in some cases Commission staff have granted waivers of GPI No. 3(17) to permit a pipeline financed solely by equity to use its parent's cost rates for long-term financing, those orders involved granting waiver of and an exception to, not an interpretation of, GPI No. 3(17).¹⁹⁶

Debt Capital" was subsequently moved from 18 C.F.R. § 154.63(f) to 18 C.F.R. § 154.312(h) and retitled as "*Statement F-3. Debt Capital*").

¹⁹³ See DETI Reply Memorandum at 7-9.

¹⁹⁴ DETI Reply Memorandum at 7.

¹⁹⁵ See, e.g., Audit Staff Reply Memorandum at 4 ("the AFUDC formula is based on a weighing of embedded costs of debt and equity, and significant components of the formula *use a utility's prior year's ending long-term debt and equity book balances and applicable cost rates* for sources of construction financing") (emphasis added, footnote and citations omitted); Audit Staff Initial Memorandum at 7 ("DETI acknowledged that it did not receive a waiver of the AFUDC accounting requirements of GPI No. 3(17). As such, DETI was required to use its own long-term debt, short-term debt, preferred stock, common equity, and CWIP balances and associated cost rates").

¹⁹⁶ See, e.g., Audit Staff Initial Memorandum at 11 ("Just because the Commission has approved the use of a parent company's capital structure in some cases does not mean

74. We similarly reject DETI's assertion that audit staff's interpretation of GPI No. 3(17) "violates the principle that pipelines cannot trace the source of funds used for various corporate purposes."¹⁹⁷ First, this contention rests on DETI's claim, rejected above, that audit staff believes GPI No. 3(17) requires that cost rates for long-term debt and preferred stock be a pipeline's parent company's cost rates. To the contrary, we find that GPI No. 3(17) requires application of the weighted average cost method to the pipeline's own prior twelve-month costs for long-term debt and preferred stock. This position is not advocating for "trac[ing] the source of funds." To the contrary, because DETI's short-term debt balances exceeded its CWIP balances, DETI's AFUDC rate, per GPI No. 3(17), should solely be its short-term debt rates, regardless of what sources of funds at any one time DETI may have actually drawn on to fund its construction. In sum, there is no internal inconsistency or other flaw in the Commission's or audit staff's interpretation of GPI No. 3(17), which accords with the regulation's express terms.

B. Whether Order No. 561 Authorizes DETI's Actions

75. DETI asserts that Order No. 561 stated that the purpose of the AFUDC rule is to yield a rate of return on a regulated entity's construction program that approximates the rate of return that would be allowed on rate base in a rate case, and that DETI's AFUDC calculations are consistent with this alleged purpose. DETI's summation of Order No. 561's purpose misinterprets what Order No. 561 stated regarding an interrelationship between capital used for rate case purposes and that used in AFUDC calculations and does not recognize what Order No. 561 stated regarding the differences between capital calculations used to determine a rate of return on rate base and the calculation of AFUDC.

76. First, contrary to DETI's contention, Order No. 561 does not state that the purpose of Order No. 561 and the AFUDC rate formula it promulgated is to arrive at an AFUDC rate that approximates for each regulated utility the rate of return allowed in a rate case. Rather, Order No. 561 states generally that the rulemaking "proposed to establish a uniform formulary method for determining the maximum rates to be used in computing [AFUDC]." Additionally, the notice of proposed rulemaking noted that the objective of the proposed rulemaking as a whole "was to establish a *method* which would give recognition between the capital utilized for rate case purposes and the capital components of AFUDC in a manner that would permit the regulated entity to achieve a rate of return

it has been approved in this case.").

¹⁹⁷ DETI Reply Memorandum at 8.

on its total utility operations, including its construction program, at approximately the rate which would be allowed in a rate case.”¹⁹⁸

77. We note that Order No. 561 established a method for computing the AFUDC rate that takes into account the amount, and the cost, of short-term debt available to the regulated entity, while short-term debt is not considered when calculating rate of return in a rate case. Indeed, as explained at length in the proposed rule,¹⁹⁹ the AFUDC rate formula considers short-term debt “first,” and nets it against the amount of CWIP on the regulated entity’s books. It is only if CWIP exceeds the amount of short-term debt

¹⁹⁸ Order No. 561, 57 FPC 608 at 608 (emphasis added), stating:

On May 20, 1975, the Commission issued a notice of proposed rulemaking in Docket No. RM75-27....This rulemaking proposed to establish a uniform formulary method for determining the maximum rates to be used in computing Allowance for Funds During Construction (AFUDC) and to provide accounting and reporting requirements for AFUDC which accord with the elements entering into the determination of AFUDC rates. The stated objective of the proposed rule was to establish a method which would give recognition to the interrelationship between capital utilized for rate case purposes and the capital components of AFUDC in a manner that would permit a utility to achieve a rate of return *on its total utility operations*, including its construction program, at approximately the rate which would be allowed in a rate case.

¹⁹⁹ See Proposed Rulemaking, *Uniform Systems of Accounts for Public Utilities Funds Used During Construction and Revisions of Certain Schedule Pages of FPC Reports*, 40 Fed. Reg. 23322 at 23322 (May 29, 1975), explaining as follows:

Generally, for rate case purposes, short-term debt has not been included in rate of return computations on the ground that such debt is temporary and is used for construction purposes. The proposed method for determining sources of capital for AFUDC purposes would track this rate case concept by assuming that short-term debt is the first source of financing used for construction work in progress. Any remaining construction work in progress is assumed to be financed by funds provided according to the pro rata capitalization of the company.

available to the regulated entity that this remaining amount of CWIP then earns an AFUDC rate calculated using rates for long-term debt, preferred stock, and common equity.

78. In the proceeding establishing Order No. 561, many commenters objected to the weight given to short-term debt in the AFUDC rate formula adopted by the Commission. The Commission addressed and rejected these objections in Order No. 561, noting among other grounds that: (1) short-term debt had not been previously included in rate of return computations; (2) short-term debt is used essentially for construction purposes and thus deserved a prominent place in the AFUDC rate formula; (3) the AFUDC formula properly permitted the capitalization of short-term debt cost through AFUDC; and (4) it was important to distinguish between establishing a rate for AFUDC and establishing a rate of return in a rate case.²⁰⁰ Further, as discussed in Order No. 561-A, the Commission

²⁰⁰ See Order No. 561, 57 FPC 608 at 608-609, stating:

Many respondents objected to the weight given short-term debt in the proposed rule and suggested a number of alternatives. These respondents argued that short-term debt is not necessarily the first source of construction funds, as would be indicated by the application of the proposed formula, and should be ignored or given less weight. We are not convinced, however, that we should modify the proposed formula with respect to short-term debt. It is generally impossible to specifically trace the source of funds used for various corporate purposes and it was not the purpose of our proposed rule to do so. Instead, we proposed a rule that would give a utility an opportunity to be compensated for the total cost of capital devoted to utility operations, including its construction program. In order to accomplish this, it is necessary to look to how the cost of capital is handled in a rate proceeding so that a method for determining AFUDC can be devised that will not result in double counting of the same capital cost or will not omit important categories of capital cost. Typically, short-term debt has not been included in rate of return computations for cost of service purposes on the grounds that such debt is temporary and is used essentially for construction purposes; however, the cost of such debt represents a valid and necessary expenditure for conducting utility operations which ultimately must be recovered through rates. By adopting the approach of permitting the capitalization of short-term debt cost through AFUDC, we

and rulemaking commenters recognized that, in some instances and for some regulated entities, the amount of short-term debt might exceed CWIP, resulting in AFUDC composed entirely of the regulated entity's CWIP multiplied by the weighted average short-term debt rate, and with no role played in the calculation of AFUDC by cost rates for other capital components, such as cost rates for long-term debt, preferred stock, or common equity.²⁰¹ For the foregoing reasons, the Commission has explained in detail that GPI No. 3(17)'s maximum AFUDC rate formula was not designed "to assure equivalence between AFUDC rates and a company's rate of return."²⁰²

provide such a mechanism. It should be understood that this method is for the purpose of establishing a rate for AFUDC and not for establishing a method for allocating short-term interest cost for the purpose of a rate proceeding.

²⁰¹ See Order No. 561-A, 59 FPC 1340 at 1341-42, stating in relevant part:

In the event, however, that the Commission chooses to retain the formula set forth in Order No. 561, El Paso [Natural Gas Company] requests clarification in cases where short-term debt exceeds construction work in progress to ensure that negative AFUDC rates do not result.

El Paso's point on possible negative AFUDC rates in situations where short-term debt exceeds construction work in progress is well taken. We believe that this matter can best be clarified by stating herein that if short-term debt balances exceed construction work in progress plus nuclear fuel in process of refinement, conversion, enrichment and fabrication the maximum total AFUDC rate to be utilized will be the weighted average short-term debt rate. In instances where this occurs, the entire credit for AFUDC will be recorded in Account 432, Allowance for borrowed funds used during construction – Credit."

²⁰² See, e.g., *Northern States Power Co. (Minnesota)*, 20 FERC ¶ 61,412, at 61,835 (1982) (emphasis added, footnotes omitted), stating:

NSP-M's position is predicated on an interpretation of Commission Order No. 561, 57 FPC 608 (1977), which established the existing AFUDC procedures. *NSP-M apparently perceives the objective of Order No. 561 to have been an attempt to assure equivalence between AFUDC rates*

C. Whether Other Commission Precedent and Policy Support DETI's Position

79. Although DETI argues that the Commission allowed or directed numerous companies to use the capital structure of the entity providing financing to be the basis for computing AFUDC, we have reviewed the Commission orders cited by DETI and find that they do not discuss, and do not authorize, the actions taken by DETI at issue here. First, nine of the orders cited by DETI are Commission orders reviewing the initial decisions of Commission administrative law judges in NGA section 4 general rate cases, or orders on rehearing of such Commission orders. These nine orders contain no discussion of AFUDC.²⁰³ In each case, DETI cites to the pages within these orders that

and a company's rate of return. We do not, however, concur in the company's narrow interpretation. Order No. 561 was designed to make utilities whole, to the extent practicable, with respect to their overall capital costs. Nonetheless, the achievement of continuous equivalence between the AFUDC rate and rate of return was neither contemplated nor guaranteed. Examination of NSP-M's method indicates that it would be equivalent to current Commission CWIP and AFUDC methodologies only when NSP-M's AFUDC rate and rate of return are equal. In practice, the AFUDC rate and the rate of return will rarely be precisely equalized due to: (1) the inclusion of short-term debt in the capital structure for purposes of deriving the AFUDC rate; (2) the use of different time periods in determining the AFUDC rate (historical period) and the rate of return (generally a future test period); and (3) the fact that the return on common equity utilized for AFUDC purposes is the rate authorized by the ratemaking body having primary jurisdiction, i.e., the State commission. Given these facts, NSP-M's methodology reflects incorrect treatment of CWIP.

²⁰³ DETI cites to these nine NGA section 4 rate case orders (*see* DETI Initial Memorandum at 6, n.17), which contain no discussion regarding AFUDC, and DETI relies on the specific pages or paragraphs indicated here: (1) *High Island Offshore System, L.L.C.*, 110 FERC ¶ 61,043, at P 134, *order on reh'g*, 112 FERC ¶ 61,050, *order on reh'g*, 113 FERC ¶ 61,280 (2005); (2) *Enbridge Pipelines (KPC)*, 100 FERC ¶ 61,260, at P 173 (2002), *order on reh'g*, 102 FERC ¶ 61,310 (2003); (3) *Michigan Gas Storage Co.*, 87 FERC ¶ 61,038, at 61,157-161 (1999); (4) *Transcontinental Pipe Line Corp.*, Opinion No. 414-A, 84 FERC ¶ 61,084, at 61,415, *reh'g denied*, Opinion 414-B, 85

discuss what “rate of return” should apply to the natural gas company’s rate base, and within this to the discussion of what “capital structure” – *i.e.*, what percentages of common equity, long-term debt, and preferred stock – should be used for purposes of calculating the rate of return. These orders note that it is the Commission’s preference or policy when determining what capital structure to use in the calculation of rate of return on rate base to use the pipeline company’s own capital structure, but if the pipeline’s financing is provided by another entity, such as a parent entity, the Commission will use that entity’s “capital structure” if it is not anomalous or, if it is anomalous, derive and employ a hypothetical capital structure.²⁰⁴

80. The foregoing policy is usually applied to a factual record developed by a Commission ALJ through an evidentiary hearing. Even where the factual record shows that all of a pipeline company’s equity is held by its parent and is therefore not publicly traded, the pipeline company may still be deemed to provide its own financing if it is determined that the pipeline company issues long-term debt in its own name that is not guaranteed by its parent, and has its own bond rating. Further, even where it is determined that the parent entity issues or guarantees all of the pipeline company’s long-term debt financing and owns all of the pipeline’s equity, the parent’s capital structure may be rejected as anomalous, and a hypothetical capital structure derived from those of publicly traded proxy companies, or one approved by the Commission for other regulated pipelines, may be adopted by the Commission.

81. DETI does not attempt to explain how the foregoing rate-case policy translates into a Commission policy regarding calculation of AFUDC and, moreover, a policy that would govern the factual situation in this proceeding. As explained previously, AFUDC differs from rate of return on rate base. The AFUDC calculation focuses first on comparing a regulated entity’s short-term debt to its CWIP. Where the regulated entity’s short-term debt exceeds its CWIP, there is no role to play, in calculating the AFUDC rate, for the cost rates of common equity, long-term debt or preferred stock, or for “capital

FERC ¶ 61,323 (1998), *pet. for review denied*, *N.C. Util. Comm’n v. FERC*, 203 F.3d 53 (D.C. Cir. 2000) (*per curiam*); (5) *Williams Natural Gas Co.*, 77 FERC ¶ 61,277, at 62,190-191 (1996); (6) *Panhandle Eastern Pipe Line Co.*, Opinion No. 404, 74 FERC ¶ 61,109, at 61,359 (1996); (7) *Arkansas Louisiana Gas Co.*, Opinion No. 235, 31 FERC ¶ 61,318, at 61,728-729 (1985); (8) *Transcontinental Gas Pipe Line Corp.*, 60 FERC ¶ 61,246, at 61,823 (1992), *reh’g denied*, 64 FERC ¶ 61,039 (1993), *rev’d on other grounds*, *N.C. Utils. Comm’n v. FERC*, 42 F.3d 659 (D.C. Cir. 1994), *order on remand*, *Transcontinental Gas Pipe Line Corp.*, 71 FERC ¶ 61,305 (1995); and (9) *Panhandle Eastern Pipe Line Co.*, 71 FERC ¶ 61,228, at 61,828 (1995), *reh’g denied*, 83 FERC ¶ 61,353 (1998).

²⁰⁴ See, e.g., *High Island Offshore System, L.L.C.*, 110 FERC ¶ 61,043 at P 134.

structure” as that term is employed in the rate of return on rate base context. Similarly, in the rate of return on rate base context, short-term debt is not considered at all.

82. There is no express discussion of AFUDC in these nine NGA section 4 rate case orders cited by DETI, and we do not discern any unstated or inchoate implications for calculating AFUDC. The rate of return on rate base policy does not provide guidance on when and under what factual circumstances, it would be appropriate for AFUDC purposes to use a parent entity’s consolidated short-term debt and consolidated CWIP book balances when a regulated entity has short-term debt on its books. Similarly, there is no discussion that, expressly or implicitly, explains whether it would be appropriate to reject a comparison of a parent entity’s consolidated short-term debt and consolidated CWIP book balances for purposes of calculating AFUDC and instead use those of a proxy group. There is also no discussion in these orders that, explicitly or implicitly, answers the question of whether authorization to use a parent’s consolidated short-term debt and CWIP balances or, alternatively, a hypothetical one, would be granted on a project-by-project basis, or *carte blanche* for the life of a regulated entity, or on some other temporal basis. In sum, the cited orders do not constitute a statement of policy or preference by the Commission regarding how to calculate AFUDC.

83. DETI also cites to two additional Commission orders, which again pertain to determining capital structure in the context of calculating a rate of return on rate base, but these two orders pertain to intrastate pipelines offering jurisdictional transportation under the Natural Gas Policy Act (NGPA), rather than the NGA.²⁰⁵ DETI cites one additional order discussing the same topic with respect to jurisdictional transportation service offered by an oil pipeline.²⁰⁶ These three orders, too, make no mention of AFUDC. For reasons similar to those discussed above, these orders do not, expressly or implicitly, state a Commission policy pertaining to the calculation of AFUDC, and in particular do not address or answer when, if ever, it is appropriate, in the context of determining AFUDC, to rely on the use of a parent entity’s consolidated short-term debt and consolidated CWIP book balances when a regulated entity’s short-term debt exceeds its CWIP.

84. DETI does cite to three other Commission orders that discuss AFUDC, and specifically address how AFUDC will be calculated in the context of rates for new

²⁰⁵ See DETI Initial Memorandum at 6, n.17 (citing, *inter alia*, *Louisiana Intrastate Gas Corp.*, 52 FERC ¶ 61,297, at 62,188-89 (1990), *aff’d in part, rev’d in part*, *Louisiana Intrastate Gas Corp. v. FERC*, 962 F.2d 37 (D.C. Cir. 1992); *Delhi Gas Pipeline Corp.*, 43 FERC ¶ 61,024, at 61,068 (1988)).

²⁰⁶ See DETI Initial Memorandum at 6, n.17 (citing, *inter alia*, *Williams Pipe Line Co.*, Opinion No. 154-B, 31 FERC ¶ 61,377, at 61,836, *modified on other grounds*, Opinion No. 154-C, 33 FERC ¶ 61,327 (1985)).

pipeline companies constructing a major greenfield project.²⁰⁷ In these three orders, the Commission authorized the regulated entities to use their respective parent entities' "capital structure" in the AFUDC calculation process. These three orders fall within a larger class of cases dealing with calculating AFUDC in the context of greenfield pipelines or other major new projects. The Commission has long recognized that the AFUDC rate formula in GPI No. 3(17) cannot be applied in the context of such new companies because they do not have the prior-year book balances for long-term debt, preferred stock and common equity called for by the formula and, similarly, do not have the prior-year weighted average cost rates for long-term debt and preferred stock called for by the formula. With respect to this situation, the Commission has adopted what it sometimes has referred to as a "project financing approach" to determining AFUDC in the context of determining whether a proposed rate is just and reasonable.²⁰⁸

²⁰⁷ See DETI Initial Memorandum at 5-6, nn. 16 and 17 (citing *Garden Banks*, 78 FERC 61,240; *Chevron U.S.A. Inc.*, 81 FERC ¶ 61,183, at 61,807 (1997); *CenterPoint Energy Gas Transmission Co.*, 119 FERC ¶ 61,138, at P 24, *clarification granted*, 121 FERC ¶ 61,004 (2007)).

²⁰⁸ See, e.g., *Alliance Pipeline L.P.*, 80 FERC ¶ 61,149, at 61,602 (1997), explaining:

Alliance is a newly-formed entity whose purpose is to construct and operate the facilities that are the subject of this [certificate] application. Consequently, capital balances and cost rates used in the Commission's AFUDC rate formula either do not exist or may not result in an appropriate measure of the cost rate of the funds that will be devoted to the construction of the proposed facilities.... In cases involving circumstances similar to those in Alliance, the Commission has directed companies to use a project financing approach for determining the cost of funds (*i.e.*, AFUDC) that should be capitalized as part of the original cost of the project. Under a project financing approach, the actual net cost of debt (short-term and long-term) and equity specifically issued for the construction will be capitalized.

See also, e.g., *Pine Needle LNG Co., LLC*, 75 FERC ¶ 61,121, at 61,409 (1996) ("Under the circumstances, it is appropriate for Pine Needle to follow a project financing approach for determining the cost of funds (*i.e.*, AFUDC) that should be capitalized as part of the original cost of the [LNG storage] project"); *Maritimes & Northwest Pipeline, L.L.C.*, 76 FERC ¶ 61,124, at 61,673 (1996) ("Because Maritimes is a newly formed entity,

85. Similar to the AFUDC formula in GPI No. 3(17), the project financing approach consists of a series of steps that looks first to less expensive and shorter term financing, and then to the longer term and usually more expensive financing if such is still needed to determine the time value of any remaining CWIP not deemed to be financed by the less

capital balances and cost rates used in the Commission's AFUDC rate formula either do not exist or would not result in an appropriate measurement of the cost rate for the funds that will be devoted to the construction of the proposed [interstate natural gas pipeline] facilities. Under the circumstances, it is appropriate for Maritimes to follow a project financing approach for determining the cost of funds (i.e., AFUDC)", *on reh'g*, 80 FERC ¶ 61,136 (1997) (not further addressing AFUDC); *Portland Natural Gas Transmission System*, 76 FERC ¶ 61,123, at 61,659 (1996) (directing that "a project financing approach" be used to determine the AFUDC to be included in the original cost of specific new project to be constructed by new entity), *on reh'g*, 80 FERC ¶ 61,121 (1997) (not further addressing AFUDC); *Millennium Pipeline Co., L.P.*, 97 FERC ¶ 61,292, at 62,326-327 (2001) (applying "a project financing approach" to calculating AFUDC for Millennium's pipeline project and also capping any resulting AFUDC rate at the "overall project capitalization and cost rates"), *on reh'g*, 100 FERC ¶ 61,277 (2002) (not further addressing AFUDC); *Greenbrier Pipeline Co., LLC*, 101 FERC ¶ 61,122, at PP 107-108 (2002) (approving Greenbrier's proposal to determine AFUDC "using the 'project financing' approach" as a "proper application" of that approach), *on reh'g*, 103 FERC ¶ 61,024 (2003) (not further addressing AFUDC calculation method).

expensive methods.²⁰⁹ When applying this approach, the Commission has used the cost rates of the common equity, long-term debt, and short-term debt, if any, that the project company itself has issued to finance the specific project being constructed, with the cost rate for common equity being the rate determined to be applicable to the project once it is in service.²¹⁰ Where the new entity applying for a certificate represents that all financing

²⁰⁹ See, e.g., *Alliance Pipeline L.P.*, 80 FERC at 61,602-03 (emphasis added, footnote omitted), stating:

The project finance approach as directed by the Commission in similar cases involves the use of the following procedures:

- First, the company may only capitalize the net cost of funds required to finance construction of the project. Therefore, AFUDC may only be computed on the amount of construction costs that are not financed from zero cost capital. Since deferred income taxes represent a source of cost-free capital, the company must reduce the total project costs by the amount of deferred income taxes recorded in Account 282, Accumulated Deferred Income Taxes – Other Property, for book/tax differences to determine the net construction costs requiring financing;
- Second, the company must capitalize the interest costs (net of any interest income) of any short-term debt issued to finance the project;
- Third, the company must capitalize the interest costs (net of any interest income) of any long-term debt issued to finance the project; and
- Fourth, *any remaining construction costs [i.e., CWIP] not financed by deferred income taxes, short-term debt, or long-term debt are deemed to be funded by common equity.* A company must therefore capitalize the associated cost of common equity through application of the Commission prescribed cost of equity rate to the amount of construction costs [i.e., CWIP] financed by equity capital.

²¹⁰ See, e.g., *Alliance Pipeline L.P.*, 80 FERC at 61,602 (“Under a project financing approach, the actual net cost of debt (short-term and long-term) and equity

for the project will come in the form of capital contributions from one or more parent entities, cost rates incurred by such parent entities may be employed under the project financing approach, and in some cases the parent entity's cost rates for long-term debt and common equity may be the same rates used in the context of calculating a return on equity for the permanent financing of a project applicable once the project is in service.

86. The three cases relied on by DETI fall into the subset of AFUDC orders involving a new entity constructing a new, discrete project, and a further subset in which the new entity avers that all project financing will be in the form of capital contributions from a parent or parent entities. In *Garden Banks*, for example, the Commission observed that: “Garden Banks is a new entity formed for the purpose of constructing, owning[,] and operating discrete facilities.”²¹¹ The Commission further held that: “Consequently, capital balances and cost rates used in the Commission’s [AFUDC] formula either do not exist or may not result in an appropriate measure of the cost of funds devoted to construction of the proposed facilities.”²¹² Further, *Garden Banks* represented that it would solely “finance the construction of the facilities with capital contributions from its members in proportion to their membership interest.”²¹³ Because the Commission determined that its AFUDC formula in GPI No. 3(17) either could not be applied in the circumstances of this new entity because of missing prior-year cost balances and prior-year cost rates or because the formula might not result in an appropriate measure of the cost of funds, the Commission determined that AFUDC should be accrued or capitalized “under the circumstances of this case” using a “maximum allowable AFUDC rate ... determined using the parents’ actual weighted debt/equity capital structure” with the cost rate for debt being the parents’ “actual weighted average cost rate for these [debt] securities” and the equity cost rate being the rate of return approved for the project by the Commission in its order.²¹⁴ The other two cases DETI cites involved similar circumstances of a new company or entity constructing a discrete new major project

specifically issued for the construction will be capitalized”); *Pine Needle*, 75 FERC at 61,409 (“During the construction period, Pine Needle expects approximately 100 percent of financing requirements (i.e., \$107 million) will be in the form of debt, primarily from commercial banks and/or insurance companies. Pine Needle asserts that at the time commercial operation commences, permanent capital equal to 50 percent long-term debt and 50 percent equity will be obtained from its creditors and from its members, respectively”).

²¹¹ *Garden Banks*, 78 FERC at 61,240.

²¹² *Id.*

²¹³ *Id.*

²¹⁴ *Id.*

seeking to determine how to calculate the amount of AFUDC to be included in the original cost of such discrete major project.²¹⁵

87. DETI selectively relies on portions of the discussions in these orders to conclude that its action is “consistent with our policy for establishing pipeline rates of return; it directs the use of the actual capital structure of the entity that does the financing for the regulated entity, whether that entity is the regulated pipeline itself or its parent.”²¹⁶ According to DETI, this should be deemed a policy statement by the Commission that where a regulated entity gets most or all of its financing from a parent entity, the AFUDC formula in GPI No. 3(17) does not apply, or if it does apply, is calculated using consolidated short-term debt, CWIP and other balances of the parent entity instead of using the regulated entity’s short-term debt and CWIP balances.

88. We reject DETI’s assertion that language in *Garden Banks* and similar orders was intended to set, or should be viewed as setting, a policy for how to calculate AFUDC over the lifetime of a regulated natural gas company, whether or not it obtains a significant amount of financing from a parent entity. The two principal factual factors in these orders that explain the Commission’s determinations were: (1) that they dealt with a new regulated entity; and (2) that such new entity had averred that all of its financing for the specific project at issue was being provided in the form solely of long-term financing from its parent or parent entities. In this narrow circumstance of a new entity, and that entity’s first project, the Commission held that its formula in GPI No. 3(17) could not be

²¹⁵ See *Chevron U.S.A. Inc.*, 81 FERC at 61,807 (holding that Venice Gathering Company’s (VGC’s) “maximum allowable VGS rate” for purpose of calculating AFUDC to be included in original cost of new facility would be determined using “parents’ debt/equity capital structure” with cost rate of debt and preferred stock being parents’ weighted average cost rate for debt and cost rate of equity being the rate of return approved for the project by the Commission, because the formula in GPI No. 3(17) “does not contemplate the formation of new entities such as VGS whose purpose is to construct and own discrete new facilities, nor does it necessarily address situations in which the entities[’] owners are the source of construction funding” and VGS represented that project would be funded solely by “parent companies using internally generated funds”); *Entegra Gas Pipeline Inc.*, 112 FERC ¶ 61,177 at PP 48-49, 67 (noting that GPI No. 3(17)’s formula “uses prior year book balances and cost rates of borrowed funds and other capital. In cases of newly created entities, such as Entegra Gas Pipeline, prior year book balances do not exist; therefore, using the formula contained in Gas Plant Instruction 3(17) could produce inappropriate amounts of AFUDC,” and directing Entegra “to capitalize the actual cost of borrowed and other funds, [used] for construction purposes” but “not to exceed the amount of ... AFUDC that would be capitalized based on the overall rate of return” approved in the order).

²¹⁶ DETI Initial Memorandum at 5 (quoting *Garden Banks*, 78 FERC at 61,240).

applied, because the new entity had none of the prior-year debt balances and prior-year capital rates called for by the formula. Further, because the new entity specified that for its first project it would not have access to any short-term debt financing, and that all financing would be long-term debt or equity financing coming from the parent(s), the factual circumstances limited the only available financing to long-term financing, the same factual circumstances when determining rate of return, which only takes into account long-term financing. These factual circumstances are not present here, however, when considering how to calculate AFUDC for a mature natural gas pipeline company like DETI, rather than a new, regulated entity. An operating natural gas pipeline may obtain short-term financing, issue short-term debt, and develop its own short-term debt book balances regardless of whether it principally gets most of its financing, or all of its long-term financing, from a parent entity. The holdings in *Garden Banks* and similar cases are limited to authorizing how to calculate AFUDC for the specific projects at issue in those cases. They did not grant the regulated entities involved a lifetime exemption from the AFUDC formula in GPI No. 3(17) and the orders contain no discussion about exempting these entities from calculating AFUDC over the course of their operations using their own book balances of short-term debt and CWIP. To construe these orders as granting such a lifetime waiver would undermine the Commission AFUDC formula's focus on using short-term debt first to finance construction, netting that against CWIP, and only applying long-term financing rates to the amount of CWIP not financed by short-term debt. Moreover, they disprove DETI's argument that no waiver is needed to apply an AFUDC formula different than the one articulated in GPI No. 3(17).

89. Finally, DETI cites to an additional Commission order, *CenterPoint Energy Gas Transmission Co.*,²¹⁷ which involved the calculation of AFUDC for a mature regulated pipeline company, and also cites two delegated letter orders, signed by the Chief Accountant approving requests, submitted by two DETI affiliates, for waivers of the Commission's AFUDC formula.

90. The Commission's *CenterPoint Energy* order does not support DETI's position. CenterPoint Energy Gas Transmission (CEGT) was a wholly-owned subsidiary and did not itself "issue debt or equity on a stand-alone basis."²¹⁸ CEGT stated that its proposed \$41.3 million project (a Phase III expansion of a new line) would be entirely "financed by available funds and short-term borrowings," and CEGT "propose[d] to exclude the equity component in the calculation of" its AFUDC rates for the project.²¹⁹ In a response to a Commission audit staff data request, CEGT had further stated that it intended to use as its cost rate for calculating AFUDC the 13-month average of the monthly interest rates

²¹⁷ 119 FERC ¶ 61,138 (2007) (*Centerpoint Energy*).

²¹⁸ *Id.* at 61,860.

²¹⁹ *Id.*

charged by CEGT's parent on borrowings made by subsidiaries from the parent company.²²⁰

91. In its order, the Commission stated that CEGT could use its proposed AFUDC rate *provided* that "it was less than the maximum rate determined under the [GPI No. 3(17)] formula prescribed."²²¹ Further, in emphasizing that CEGT was to apply the AFUDC formula to determine a maximum AFUDC rate that it could not exceed, the Commission noted that under the formula, CEGT could not simply use a rate based on 100 percent equity and its parent's cost rate for equity. The cost-rate for equity would be based on its parent's percentages of long-term debt and common equity (i.e., capital structure), and the cost rates for such long-term financing.²²² Further, CEGT did not represent that it had short-term debt balances, and the Commission therefore did not address in *CenterPoint Energy* whether CEGT or any regulated entity could exclude its own available short-term debt balances in applying the AFUDC rate formula found in GPI No. 3(17), and did not address any request by CEGT to use its parent entity's monthly short-term consolidated debt and monthly consolidated CWIP balances to determine whether there remained any CWIP on which to apply long-term financing rates.

92. In short, in the only Commission proceeding that DETI cites that involved a mature regulated natural gas utility and AFUDC, the order emphasized that the Commission's AFUDC rate formula in GPI No. 3(17) did apply, and that the formula set the maximum AFUDC rate above which it would not be permissible for CEGT to use. The order did not address or otherwise authorize CEGT to calculate AFUDC using its parent's monthly short-term debt and CWIP balances instead of its own. We find that *CenterPoint Energy* is distinguishable from DETI's circumstances and does not provide support for DETI's argument. Moreover, in the context of granting a case-specific waiver, it does not set forth a policy authorizing regulated natural gas entities to not use their own monthly book balances of short-term debt and CWIP if they receive long-term financing from a parent entity. Rather, it highlights that DETI should have sought a

²²⁰ CEGT's Response to Commission's Staff Data Request, Docket No. CP07-41-000 (Feb. 26, 2007).

²²¹ *CenterPoint Energy*, 119 FERC at 61,860.

²²² *Id.* ("Commission policy in cases where a subsidiary does not issue long-term debt, and does not provide its own financing, is to require the subsidiary to use the actual capital structure of the entity that does the financing for the regulated pipeline. CEGT is directed to utilize the formula established in Order No. 561 to calculate the maximum allowable AFUDC rate based on the actual capital structure of its parent company, CenterPoint Energy Resources Company. CEGT may elect to utilize its proposed AFUDC rate provided that it is less than the maximum rate determined under the formula prescribed").

waiver, as did CEGT, if DETI sought to depart from, and exceed, the formula in GPI No. 3(17).

93. As previously noted, DETI also relies on two delegated Commission letter orders granting requests for waivers of the maximum AFUDC formula in GPI No. 3(17), that were submitted by two DETI affiliates.²²³ The two requests sought “waivers” of the formula so as to “result in a lower allowance for funds used during construction (AFUDC) rate than would be derived using the actual book balances of [Dominion Carolina Gas Transmission, LLC (“DCG”) or Dominion Cove Point LNG, LP (“DCP”).”²²⁴ Importantly, each entity represented that it has no short-term debt book balances of its own and, indeed, that it maintains no book balances used in the Commission’s AFUDC rate formula other than common equity.²²⁵ DCG and DCP further represented that the cost rate for common equity for each would be the relatively high (compared to the short-term financing rates otherwise employed in calculating AFUDC) with imputed return on equity rates of, respectively, 12.7 percent and 11.9 percent set in each entity’s last rate case settlements.²²⁶ Although DCG represented that it obtains its equity financing from Dominion Midstream Partners, LP (DM), DCG stated that DM’s capital structure of

²²³ See DETI Initial Memorandum at 6 and n.16, and 11 and n.38 (citing *Dominion Cove Point LNG*, Docket No. AC16-61-000 (Sept. 28, 2016) (delegated order) (DCP Letter Order); *Dominion Carolina Gas Transmission LLC*, Docket No. AC16-57-000 (Sept. 28, 2016) (delegated order) (DCG Letter Order)).

²²⁴ Request for Waivers of Order No. 561 and Gas Plant Instruction No. 3(17), *Dominion Carolina Gas Transmission, LLC*, Docket No. AC16-57-000 (Mar. 8, 2016), at 1 (DCG Waiver Request); Request for Waivers of Order No. 561 and Gas Plant Instruction No. 3(17), Docket No. AC16-61-000 (Mar. 16, 2016), at 1 (DCP Waiver Request).

²²⁵ DCG Waiver Request at 2 (“DCG no longer has outstanding short- or long-term debt on its books. If DCG were to use its actual book balances to calculate AFUDC, the capital structure would be 100% equity”); DCP Waiver Request at 2 (“DCP has no outstanding short- or long-term debt on its books. If DCP were to use its actual book balances to calculate AFUDC, the capital structure would be 100% equity”).

²²⁶ DCG Waiver Request at 2-3 (stating that DCG’s actual book balances of 100 percent equity “would yield an AFUDC rate of 12.7% -- the return on equity agreed to in DCG’s last rate settlement”) (citation omitted); DCP Waiver Request at 2 (stating that DCP’s actual book balances of 100 percent equity “would yield an AFUDC rate of

11.95 – the imputed return on equity based on the pre-tax return stipulated in DCP’s last two rate settlements”) (citation omitted).

83 percent equity to 17 percent debt would “result in an anomalously high AFUDC rate” and accordingly DCG proposed, instead, using the “hypothetical capital structure of 50 percent debt and 50 percent equity (consistent with the stipulation in its last rate case settlement),” the rate of return on equity from its last rate case, and DM’s cost of long-term debt to arrive at an AFUDC rate of 6.65 percent.²²⁷ DCP proposed, instead of using its actual book balances of 100 percent equity, to use its parent’s capital structure of 66 percent debt and 34 percent equity, its rate case settlement rate of return on equity, and its parent’s costs of short-term and long-term debt, and proposed that any other elements used in the AFUDC formula be based on book balances and cost rates of its parent.²²⁸

94. The two Chief Accountant delegated letter orders granting, respectively, DCG’s and DCP’s request for waivers each stated that “Order No. 561 did not specifically address a situation where a regulated entity does not provide its own financing of its construction projects.”²²⁹ Each letter order further observed that “[f]or purposes of return on equity and capital structure, if the regulated pipeline does not provide its own financing, the Commission policy is to use the actual capital structure of the entity that does for the regulated pipeline.”²³⁰ DCG’s order adds that the parent’s capital structure will be rejected if it is “abnormal relative to the capital structures approved for other regulated pipelines,” in which case the Commission may employ a hypothetical capital structure.²³¹ The two letter orders accepted the DETI affiliates’ proposed alternatives to applying the formula in GPI No. 3(17) which, each letter order stated, would have resulted in an improperly high AFUDC maximum rate given that each entity only had book balances of equity.²³² However, each letter order capped any AFUDC rate that might result from application of the proposals at the allowed weighted-average cost of capital used in the two entities’ respective last rate settlements.²³³ Further, each letter

²²⁷ DCG Waiver Request at 3.

²²⁸ *Id.*

²²⁹ DCP Letter Order at 2-3; DCG Letter Order at 2.

²³⁰ DCP Letter Order at 3; DCG Letter Order at 2.

²³¹ DCG Letter Order at 2.

²³² DCP Letter Order at 3 (granting proposal to “avoid recording of improper amounts of AFUDC using the formula envisioned in Order No. 561 and GPI No. 3(17)”; DCG Letter Order at 3 (same).

²³³ *Id.* at 1, 3 (accepting proposal “provided that the proposed methodology results in an AFUDC rate that would permit DCP to achieve a rate which approximates the allowed components of its weighted-average cost of capital calculation in its last rate

order specified that if either entity should cease relying solely on financing from another entity, it “should determine its AFUDC rate, consistent with the requirements of Order No. 561 and GPI No. 3(17).”²³⁴

95. DETI contends that these two Chief Accountant delegated letter orders granting requests for waivers made by its affiliates show that “substantively, DETI’s practice of computing AFUDC using its parent company’s book balances is appropriate.”²³⁵ DETI asserts that it sees no difference between its factual circumstances and those of its two affiliates, except that it did not request a waiver while they did, and alleges it is being “punish[ed] ... for failure to obtain express permission,”²³⁶ and claims that Commission audit staff is acting arbitrarily in granting waivers to its two affiliates while seeking to enforce the Commission’s AFUDC rate formula against DETI.²³⁷

96. DETI’s equating its circumstances to those of its two affiliates is inaccurate, and its reliance on the two letter orders is misplaced. The salient fact in its two affiliates’ circumstances is that, according to their representations, they had no book balances other than equity. Thus, they had no monthly balances of short-term debt, for example, to be used to finance their monthly CWIP balances (thereby reducing the amount of CWIP to be financed using longer term debt or equity), as well as no prior year balances of long-

settlement”); DCG Letter Order at 1 (“Based on DCG’s representations and the Commission’s approval [in another DCG case] of DCG using a capital structure of 50 percent debt and 50 percent equity and an equity rate of 12.7 percent for rate purposes, its request for a waiver is granted. DCG should quickly inform us in case it receives a new rate case settlement that addresses its capital structure and equity rate to allow us to evaluate the appropriateness of its AFUDC determination”).

²³⁴ *Id.* at 1 (“In case DCP discontinues relying on financing by another entity, DCP should determine its AFUDC rate, consistent with the requirements of Order No. 561 and GPI No. 3(17)”); DCG Letter Order at 1 (“In case DCG discontinues relying on financing by another entity, DCG should determine its AFUDC rate, consistent with the requirements of Order No. 561 and GPI No. 3(17)”).

²³⁵ DETI Initial Memorandum at 19.

²³⁶ *Id.*

²³⁷ *See, e.g.*, DETI Initial Memorandum at 11-12 (arguing that it would be fundamentally unfair, and “cherry picking,” to permit DCP to use its parent’s capital structure but fault DETI for ignoring its own accounting book balances and employing consolidated book balances of its parent).

term debt, preferred equity or common equity, to be used in GPI No. 3(17)'s formula for determining the maximum AFUDC rate.

97. In contrast, as found in the Audit Report and not contested by DETI, throughout the period covered by the contested finding and recommendations, DETI had short-term debt book balances in excess of its monthly CWIP balances. Pursuant to the Commission's regulations, specifically GPI No. 3(17) and the formula contained therein, as well as Order Nos. 561 and 561-A, DETI was required to look to this short-term debt first in calculating its maximum rate of AFUDC, and to employ long-term financing rates only to the extent its monthly CWIP balances exceeded its available short-term debt, which never occurred. The factual circumstances presented by DETI's two affiliates are substantially different than those presented in this contested audit proceeding, and merit different results. The Chief Accountant delegated letter orders granting the waivers do not reflect a Commission policy of looking to the consolidated CWIP and consolidated short-term debt balances of its parent entity, simply on the basis that the regulated entity has received long-term financing from a parent entity. DETI has not cited or directed us to a single order discussing or adopting such a policy. Furthermore, the Commission has a general rule that any waivers or similar authorizations granted by the Commission are specific to the case in which they are granted and do not establish any new policies or accounting guidelines of general applicability.²³⁸ Accordingly, given the substantially different factual circumstances between DETI's situation and that of its two affiliates, DETI was in error to assume (1) that its methodology and practice for calculating AFUDC was either an appropriate one, or consistent with the Commission's accounting regulations and precedent or (2) that the waivers granted its affiliates indicate that DETI's actions were substantively appropriate.

98. To summarize the foregoing discussion of precedents: twelve of the orders DETI relies on contain no discussion of AFUDC, and relate instead to the different regulatory context of determining capital structure and rate of return on rate base in the context of rate cases. Three more orders relate to determining AFUDC in the context of a new entity building a new, discrete major project that has no short-term debt or other financing of its own, also not the circumstances involved here. One order does relate to AFUDC in the context of an ongoing, mature pipeline company, but expressly states that the regulatory formula in GPI No. 3(17) applies and forms a maximum limit applicable to any AFUDC rate developed by that pipeline. Finally, the two Chief Accountant delegated letter orders granting waivers to DETI's affiliates pertain to the circumstance of entities that lack all of the components of the regulatory formula except equity, and such equity is provided by a parent entity – again, not a precedent applicable to the

²³⁸ See, e.g., *Transcontinental Gas Pipe Line Corp.*, 42 FERC ¶ 61,232, at 61,761 (1988) (granting waiver and “clarify[ing] that our action here is limited to the facts of this case and does not establish any policy”).

circumstances here. Contrary to DETI's claim that the Commission's policies and precedent *required* that DETI ignore its own book balances – and in particular ignore that its own short-term debt balances exceeded its CWIP balances,²³⁹ we do not find any such precedent or policy.

99. We also do not find persuasive the other arguments that DETI makes that would permit regulated natural gas companies to not use their own book balances, particularly their own short-term debt and CWIP balances, when calculating AFUDC. For example, DETI points to a 2008 revision of page 218a of the Commission's Form No. 2, on which pipelines disclose their AFUDC calculations. The revision required pipelines to begin identifying “the specific entity used as a source for the capital structure figures.”²⁴⁰ A recognition, however, that in some instances a pipeline's long-term debt or equity components may consist entirely of capital from a parent entity and should be valued based on the parent entity's percentages of debt and equity (i.e., its “capital structure”) does not equate to authorization to exclude the short-term debt balances and other sources of financing construction shown on a regulated entity's own books.

100. DETI states that the Commission has recognized that Order No. 561 was not designed for situations in which a regulated entity obtains all of its financing from another entity.²⁴¹ The Commission has on occasion made similar, though somewhat more limited, statements regarding the potential applicability of Order No. 561.²⁴² However, such statements do not announce a policy stating that either a group of

²³⁹ See, e.g., DETI Initial Memorandum at 9 (asserting that it is a “false premise, that DETI should have utilized its own book balances to compute AFUDC, instead of those of its parent company,” and claiming that “the Commission requires pipelines like DETI” to use all of their parents' book balances, not such regulated entities own short-term debt and CWIP balances).

²⁴⁰ DETI Initial Memorandum at 7 (citing Guest Affidavit, Exh. DETI-3, at 4:6-12 (itself citing *Revisions to Forms, Statements, and Reporting Requirements for Natural Gas Pipelines*, Order No. 710, 122 FERC ¶ 61,262, at PP 41-43 (2008))).

²⁴¹ See, e.g., DETI Initial Memorandum at 8 (asserting that “the Commission recognizes that Order No. 561 did not address situations where an entity does not do its own financing”), citing to the DCP Letter Order.

²⁴² See, e.g., *Garden Banks*, 78 FERC at 61,240 (“the formula does not necessarily address situations in which the entities' owners are the source of construction financing”); *Chevron U.S.A. Inc.*, 81 FERC 61,807 (“The formula, however, does not contemplate the formation of new entities such as VGS whose purpose is to construct and own discrete new facilities, nor does it necessarily address situations in which the entities' owners are the source of construction financing”).

regulated natural gas companies is free to depart from the maximum AFUDC rate set forth in GPI No. 3(17), or that such group or classification of regulated pipelines can overlook, for example, that their own short-term debt balances exceed their CWIP. As noted above, it bears repeating that DETI has not pointed to any Commission orders discussing or adopting such a policy with respect to any group or classification of regulated natural gas companies.

101. In this same vein, DETI asserts that no waiver or permission is required for a pipeline to compute AFUDC using the capital structure of the entity providing its financing.²⁴³ Putting to one side the interpretation and accuracy of this statement, we note that DETI did more than draw upon the capital structure (i.e., the percentage of debt and equity) of its parent. At all times relevant to the disputed Audit Report finding, DETI did not comply with the Commission's regulations in GPI No. 3(17) that required DETI's AFUDC to be calculated using DETI's short-term debt costs due to its short-term debt balances exceeding its CWIP balances and the fact that DETI exceeded the maximum rate under GPI No. 3(17)'s formula when it relied on its parent entity's consolidated book balances and cost rates.

D. Whether Other Grounds That DETI Offers For Not Applying GPI No. 3(17) Are Persuasive

1. Lack of Notice and Alleged Arbitrary Departure from Existing Commission Policy

102. DETI argues that the Audit Report's requirement that DETI use its own book balances to calculate AFUDC is arbitrary, capricious, fails to provide due process and constitutes a departure from Commission policy without providing a reasoned explanation.²⁴⁴ DETI asserts that the Commission's audit staff is creating a new policy that requires all pipelines to compute AFUDC using their own book balances, regardless of the source of their financing, or alternatively, to file with the Commission for authorization to use the parent's or financing entity's book balances.²⁴⁵

103. We do not find DETI's arguments to be persuasive. As discussed above, GPI No. 3(17), promulgated in 1977, applies to every regulated natural gas company and sets a specific formula for determining a maximum AFUDC rate based on such regulated entity's book balances and financing costs. Further, we have previously held that "our

²⁴³ DETI Initial Memorandum at 8 (citing Guest Affidavit Exh. No. DETI-3 at 5:5-11).

²⁴⁴ *Id.* at 12-17.

²⁴⁵ *Id.* at 13.

regulations are clear and explicit that short-term debt should be included in the calculation of AFUDC rates.”²⁴⁶ We reject DETI’s argument that the Commission should have “announced a generally applicable policy” regarding calculation of a maximum applicable AFUDC. These policies were announced at the time they were adopted through a notice and comment rulemaking proceeding in Order Nos. 561 and 561-A. There has been no change in interpretation or policy and no reason to announce a policy that has been in place for more than three decades.

104. As further discussed above, there is no evidence that the Commission has allowed a regulated entity when determining its AFUDC to use the consolidated short-term debt balances and consolidated CWIP balances of a parent entity to determine whether any amount of CWIP would be deemed to be financed at the longer-term financing rates applicable to long-term debt and equity when its own short-term debt balances exceeded its own CWIP.

105. We find no merit in DETI’s claim that it has demonstrated that “the Commission requires pipelines like DETI that do not do their own financing to compute AFUDC using the book balances of ‘the entity that does the financing for the regulated pipeline, whether that entity is the regulated pipeline itself or its parent.’”²⁴⁷ While the Commission has permitted pipeline companies in the context of rate cases to calculate a rate of return on rate base employing the “capital structure” of a parent entity that provided the long-term financing to the pipeline, and has directed that entities having only equity financing held by a parent must cap their AFUDC at the rate resulting from their parent’s capital structure, the Commission does not have a policy permitting, and DETI has not demonstrated that the Commission has ever authorized in any order, a regulated entity to exclude its existing short-term debt balances in calculating AFUDC because it received long-term financing from a parent entity.

106. The Commission therefore disagrees with DETI’s assertion that the Audit Report reflects a new policy, or that it is a departure from an existing policy that requires further explanation. The Audit Report applies the existing regulations in GPI No. 3(17), and there are no Commission orders establishing a policy of applying GPI No. 3(17) in a different manner in the circumstances presented in this proceeding.

107. DETI claims that it first received notice in 2014 that audit staff might believe that the Commission’s AFUDC rate formula in GPI No. 3(17) should be applied to DETI’s

²⁴⁶ *Otter Tail Power Co.*, 119 FERC ¶ 61,217 at P 15 (footnote omitted).

²⁴⁷ DETI Initial Memorandum at 9 (emphasis added) (quoting *Garden Banks*, 78 FERC at 61,240); *see id.* at 13 (asserting that “the only reasonable interpretation of Commission’s regulations is to require pipeline companies to compute their AFUDC rates using the actual book balances of entities that provide their financing.”).

own book balances, particularly its own short-term debt balances. However, GPI No. 3(17) and Order Nos. 561 and 561-A provided notice in 1977 that the formula was to be applied using the regulated entity's book balances. Furthermore, the Commission provided notice in several other proceedings in which regulated entities sought to exclude all or part of their short-term debt balances from the calculation of AFUDC rates, and were denied such authorization.²⁴⁸ The Commission's orders in *Tennessee Gas Pipeline Co.* and *Otter Tail Power Co.*, in particular, state that a regulated entity reducing its book balances of short-term debt for purposes of its AFUDC calculations on the grounds that such reduction reflected its consolidated operations or consolidated capital flows violates GPI No. 3(17) and Order Nos. 561 and 561-A.²⁴⁹ These proceedings, as well as Order

²⁴⁸ See, e.g., *Otter Tail Power Co.*, 119 FERC ¶ 61,217 (rejecting Otter Tail's request to exclude short-term debt from its AFUDC maximum rate calculation where Otter Tail asserted that its cash management program enabled it to trace the actual use of all its funds, its sole loan agreement with lender expressly forbade Otter Tail from using any short-term debt in its regulated utility operations, and Otter Tail argued that short-term debt financing was thus not relevant to its regulated operations); *Tennessee Gas Pipeline Co.*, Order Directing Accounting Adjustment as Recommended, 64 FERC at 63,441 ("The Commission rejects Tennessee's allocation of short-term debt between utility and non-utility functions to calculate maximum AFUDC rate"), *reh'g denied through notice of no action on reh'g request*, 65 FERC ¶ 61,257 (1993); *id.* at 63,442 ("We reject Tennessee's attempt to collaterally attack Order No. 561-A"); *Minnesota Power & Light Co.*, delegated order, Docket No. AC93-204-000 (Mar. 9, 1994) (rejecting MPL's request for authorization to exclude from the Commission AFUDC formula that portion of its short-term debt used for its non-utility subsidiaries' cash requirements).

²⁴⁹ See *Otter Tail Power Co.*, 119 FERC ¶ 61,217, at PP 7, 8 (although Otter Tail argued that it was "a diversified corporation with not only utility operations, but also substantial non-utility operations in health services, manufacturing, plastics, and other businesses – all of which [were] held by Varistar Corporation, which [was] in turn held by Otter Tail Corporation," and its sole loan agreement with lender forbade use of any short-term debt for utility purposes, and its cash management program made "tracing of funds in this case [] possible," the Commission rejected any exclusion of Otter Tail's short-term debt balances from AFUDC calculation and required inclusion of full amount of such balances as consistent with intent and purposes of Order Nos. 561 and 561-A); *Tennessee Gas Pipeline Co.*, 64 FERC at 63,441-442 (rejecting reduction to book balances of short-term debt made by Tennessee in its AFUDC calculation where Tennessee argued that "it is necessary to determine first what portion of the consolidated capital structure relates to utility operations" and that its reduction "merely allocated consolidated capital, including short-term debt, among utility and non-utility operations, as a necessary first step in determining the cost of utility construction").

Nos. 561 and 561-A, provided notice to DETI that its own short-term debt balances should be used when calculating its maximum permissible AFUDC rate.

108. The discussions in *Otter Tail* and *Tennessee* also undermine DETI's repeated claim that the sole issue in this proceeding is DETI's failure to seek permission, and that DETI is being "punished" merely for not seeking authorization to do what, in DETI's view, it already was permitted to do.²⁵⁰ To the contrary, DETI's exclusion of its short-term debt balances in calculating its AFUDC, on its face violated the Commission's regulations at GPI No. 3(17) and the Commission's orders promulgating and interpreting those regulations, and required advance authorization. Had DETI sought authorization to not use its own short-term debt balances, the outcome would not have been certain, as the Commission has not previously granted such a waiver or exemption from its AFUDC regulations when a pipeline's short-term debt exceeds its CWIP balances.

2. Alleged Open and Transparent Use of DETI's "Method" of Calculating AFUDC

109. As discussed in the last section, Order No. 561, Order No. 561-A, and GPI No. 3(17), by themselves and together with the subsequent orders discussed in the preceding section that denied requests to reduce or exclude a regulated entity's short-term debt balances when calculating AFUDC, provided ample notice to regulated entities, such that there is no unfairness or lack of due process in requiring DETI to recalculate its AFUDC and related accounts employing its own short-term debt balances and its own CWIP balances. This conclusion is further confirmed by the fact, as discussed above, that none of the Commission orders cited by DETI for support states a Commission policy that the actual "account balances" for purposes of GPI No. 3(17) are those of whatever entity primarily provides financing.

110. Given the foregoing notice to regulated entities such as DETI, even assuming, *arguendo*, that, as DETI asserts, it was "transparent" from analysis of its Form No. 2 submissions or during a 2004 audit that DETI might not be using its own book balances, including its own short-term debt, when calculating AFUDC, the alleged absence of objection to DETI's AFUDC calculations until the 2015 audit did not provide "good cause" for DETI to assume it complied with Commission regulations. First, DETI had an obligation to explicitly request a waiver permitting it to exclude its own book balances of short-term debt when doing so caused its AFUDC rate to exceed the maximum rate

²⁵⁰ See, e.g., DETI Initial Memorandum at 3 ("[b]ecause DETI did not obtain such waiver, Audit Staff recommends [the adjustment]"); *id.* at 17 ("[i]t is unfair and a violation of due process to now punish DETI for alleged noncompliance with this [new] policy"); DETI Reply Memorandum at 1 ("Audit Staff's position in this proceeding rests on a single, wholly unsupported claim that DETI's application of clear Commission policy requires explicit approval by the Commission").

allowed per GPI No. 3(17)'s formula. As we held in 2007, our regulations are "clear and explicit" about the inclusion of a regulated entity's actual short-term debt balances in GPI No. 3(17)'s formula, placing an "obligation to justify a departure, *i.e.*, a waiver of those regulations" on a regulated entity.²⁵¹ Furthermore, the Commission does not approve the annual informational filings – that is, the FERC Form No. 2s – submitted by regulated natural gas companies. There is no legal or reasonable basis for the assumption underlying DETI's argument that if no objection is made by the Commission or its staff to the financial data contained in FERC Form No. 2 filings, then such data, and underlying accounting practices that generated the financial data, have been approved by the Commission or its staff.

111. While we reject DETI's "transparency" arguments for the foregoing reasons, we further find several additional reasons that DETI should not have inferred, from mere silence, that its AFUDC methodology was "transparent," and had been understood even by the Commission's staff. First, contrary to an assumption underlying DETI's argument, GPI No. 3(17) does not prescribe a specific "methodology" for calculating AFUDC that every regulated entity must follow. Instead, it prescribes a specific, express formula that, when properly applied to each regulated entity's account balances, results in a maximum AFUDC rate specific to that entity and above which that regulated entity may not go without seeking Commission authorization. This distinction is important in this context because it means that a regulated entity may vary or depart, in its "method" of calculating its AFUDC rate, in one or more ways from GPI No. 3(17)'s maximum AFUDC rate formula, without necessarily arriving at a rate in excess of the maximum rate resulting from GPI No. 3(17)'s formula. In short, an indication that a regulated entity may be departing in some manner from the formula is not, alone, proof that GPI No. 3(17)'s maximum rate has been exceeded and the regulation violated. Such proof comes only with knowledge of the complete calculations that a regulated entity is using to calculate its AFUDC rate compared with the maximum AFUDC rate that would be obtained when the regulated entity's correct data specified in GPI No. 3(17) is used in the regulation's formula. In short, an indication that DETI was doing something different than the specified formula was not itself proof that DETI was exceeding the maximum AFUDC rate and violating GPI No. 3(17).

112. DETI further argues that a revision to FERC Form No. 2 adopted in 2008 should have made transparent to all DETI's method of calculating AFUDC. This overstates the

²⁵¹ *Otter Tail Power Co.*, 119 FERC ¶ 61,217 at P 15 ("Finally, we emphasize that our regulations are clear and explicit that short-term debt should be included in the calculation of AFUDC rates ...It was and is Otter Tail's obligation to justify a departure, *i.e.*, a waiver of those regulations and that policy, and Otter Tail Power did not and has not done so").

case. The 2008 revision consists of a footnote in which a regulated entity identifies the source of its “capital structure.”

113. The addition of this footnote arose from calls for more information about “rate of return on equity” and “capital structure.” Capital structure is often understood to mean the percentages of long-term debt and equity assumed in calculating rate of return. Therefore, there is no assurance that DETI’s reference to its parent entity in this footnote would be necessarily interpreted by Commission staff or other participants as a clear message that DETI was using consolidated parent company book balances for short-term debt, long-term debt, and equity, rather than its own book balances for short-term debt or other financing. Furthermore, neither the footnote nor the information on page 218a of FERC Form No. 2 reveal that DETI excluded actual short-term debt balances, or that these exceeded DETI’s actual CWIP.

114. Indeed, the exhibit DETI relies on²⁵² shows that DETI provided two footnotes. The first stated that the “[r]ate of return [used for common equity as shown on line no. 5, column d, associated with DETI’s AFUDC calculations] is a calculated black box settlement rate approved in Docket No. RP97-406-000.”²⁵³ This would accord with GPI No. 3(17)’s instruction that the formula for the maximum AFUDC rate be calculated using a rate of return for the equity component determined in a pipeline company’s last rate case. The second footnote in DETI’s FERC Form No. 2s states, with respect to line 6, box d pertaining to “Total Capitalization,” that “Dominion Resources, Inc. was used as the source for the capital structure figures.”²⁵⁴ While this footnote could have raised the question as to how DETI was calculating its AFUDC, it would not answer that question, nor does it reveal any actual violation of the maximum AFUDC rate determined by GPI No. 3(17).

115. Even if a review of page 218a in DETI’s FERC Form No. 2s led to the conclusion that DETI had included on this page the book balances of Dominion Resources, Inc., rather than of DETI, this conclusion would not itself be proof of a violation. Only by examining DETI’s own financial data, and determining, for example, that DETI had its own short-term debt that exceeded its own CWIP, and comparing the result of the formula in GPI No. 3(17) to the result that DETI obtained using its own method of calculating AFUDC (also not found on page 218a), would Commission staff or other rate case participants be able to determine that DETI was using an AFUDC rate that exceeded the rate derived using GPI No. 3(17)’s formula. Only by doing these two calculations for multiple years would the impact of this (whether an increase or decrease in capitalized

²⁵² See Stevens Affidavit, Exh. MCS-1B, at 1-21.

²⁵³ *Id.*, Exh. MCS-1B, at 3.

²⁵⁴ *Id.*

AFUDC, and of what magnitude) be revealed. We do not find, therefore, that it was transparent, from either the footnote on which DETI relies or the data on page 218a, that DETI was exceeding the maximum AFUDC rate provided in GPI No. 3(17), nor was the impact of such violation revealed. We also note that an NGA section 4 pipeline general rate proceeding generally focuses on a pipeline's rate of return on rate base and related issues – that is, what a pipeline's rate of return should be in the future. In the context of an NGA section 4 general rate case, exploring a potential challenge to a pipeline's AFUDC rate may be overlooked.

116. DETI also points to data requests it received from Commission audit staff during a 2004 audit, and DETI's responses thereto, regarding DETI's AFUDC rate calculations. In response to these data requests, DETI asserts that it returned to audit staff "spreadsheets using the book values of the parent company, Consolidated Natural Gas Company, and using those values, described in depth how AFUDC was computed for DETI and the other affiliates" subject to FERC's regulations.²⁵⁵ DETI's witness states that because the audit staff did not raise objections about AFUDC in the subsequent audit report, DETI inferred that "it was following a Commission-approved methodology in computing AFUDC."²⁵⁶

117. First, as discussed above, the Commission's regulations do not set an AFUDC methodology that a company must use to compute its AFUDC rate, but instead set forth a formula establishing a maximum AFUDC rate specific to each regulated entity, which a company's actual AFUDC rate may not exceed. The data responses provided by DETI in 2004 and attached as an exhibit to its Initial Memorandum do not reveal that DETI had exceeded any such maximum rate. Indeed, the data responses indicate that for every quarter in 2003 and the first quarter of 2004, save one, the AFUDC rate used was equal to the cost of short-term debt – that is, short-term debt was providing 100 percent of the financing of construction.²⁵⁷ The 2004 data responses also did not make clear that it would be DETI's practice to exclude short-term debt on its books exceeding its CWIP, and employ long-term financing rates as its AFUDC rate based on the consolidated book balances of its parent entity. In particular, in a data response providing a narrative setting forth DETI's policy for calculating CWIP, DETI's response to audit staff states: "if short term debt balances exceeded construction work in progress plus nuclear fuel in process of

²⁵⁵ *Id.* at 4:17-20; *see* Exh. MCS-2 (containing data requests and responses).

²⁵⁶ *Id.* at 5:1-2.

²⁵⁷ The only period in which the "AFUDC rate" was not equal to the cost of short-term debt in the responses provided by DETI was the third quarter of 2003, and for that quarter short-term debt still provided 95.4 percent of financing, resulting in a short-term debt cost of 1.124 percent and an AFUDC rate of 1.578 percent for the quarter. *Id.*, Exh. MCS-2 at 33.

refinement, conversion, enrichment and fabrication, the maximum total AFUDC rate to be utilized for the period will be the weighted average short-term debt rate,” the very language from Order No. 561.²⁵⁸ The written policy provided in the data responses did not state that the “maximum total AFUDC rate” would be the weighted average short-term debt rate only when the consolidated short-term debt of the parent entity and all its subsidiaries exceeded consolidated CWIP for the parent and all its regulated and unregulated subsidiaries, and that DETI would not use its actual short-term debt balances and CWIP.

118. The DETI exhibits thus do not establish that the 2004 audit staff understood that DETI’s policy was, or would be, to not use its own short-term debt balances and its own CWIP, and instead apply the results of a comparison of the parent entity’s consolidated short-term debt balance to the parent entity’s consolidated CWIP. Further, those exhibits showed that in 2003 and the first quarter of 2004, the AFUDC rate that DETI employed was a rate equal to the cost of short-term debt.

119. For the foregoing reasons, we find that the record does not support DETI had good cause to infer from an absence of objection by staff during a 2004 audit and during general rate cases that its practices for calculating AFUDC were understood and authorized by the Commission. The Commission’s precedent and its regulations required DETI to request a waiver to justify setting aside its own short-term debt balances when calculating its AFUDC rate, where doing so would cause its AFUDC rate to exceed that produced by GPI No. 3(17)’s formula. It is undisputed that DETI never requested and obtained approval from the Commission to do so.

3. Policy Claims For Not Applying Order No. 561 and GPI No. 3(17) to DETI

a. Tracing Specific Sources of Capital DETI Used for AFUDC

120. DETI asserts that its parent’s capital structure (including consolidated short-term debt and consolidated CWIP balances) reflects the “true components and cost of financing” for DETI,²⁵⁹ and therefore applying the Commission’s AFUDC rate formula to DETI “would not lead to more accurate results; quite the contrary, it would lead to arbitrary results that do not reflect DETI’s true financing costs.”²⁶⁰ However, the stated purpose of Order No. 561 and the AFUDC rate formula is to look first to a regulated

²⁵⁸ *Id.*, Exh. MCS-2 at 12.

²⁵⁹ *Id.* at 10.

²⁶⁰ *Id.* at 10-11.

entity's short-term debt cost in determining the AFUDC rate and only apply other sources of financing and their cost rates to any portion of CWIP that exceeds the entity's short-term debt. DETI's claim that the purpose of the AFUDC formula is to discover the "true economics" or cost to its parent entity of each component, as construed by DETI, conflicts with and undermines the stated goal of Order No. 561 and GPI No. 3(17) of finding a means of incorporating in a regulated entity's overall rate calculations its cost rate of short-term debt financing. Further, as we have held in prior orders, it was not the intent of Order No. 561, nor is it the intent of the Commission's maximum AFUDC rate formula, to "trace the source of funds" (and such funds' cost rates) actually employed by a specific regulated entity for AFUDC or other corporate purposes.²⁶¹ DETI's arguments about attempting to reflect its parent entity's "true economics," or the alleged costs to a parent entity of specific sources of funds DETI may have received misconstrues the purposes and goal of the Commission's maximum AFUDC rate formula.

121. In a similar vein, DETI argues that during the period relevant to this proceeding, DETI's parent, Dominion, ran "an intercompany borrowing arrangement" that flowed funds to DETI needed for the latter's construction and operations not funded from current revenues or from equity. According to DETI, under this arrangement, "all such

²⁶¹ *Otter Tail Power Co.*, 119 FERC ¶ 61,217 at P 12 ("as the Commission stated in both Order Nos. 561 and 561-A, ... it was not the intent of the rule to try to trace the source of funds used for various corporate purposes"); see Order No. 561, 59 FPC at 608-609 (dismissing commenters objections to the weight given short-term debt in the rule, and stating: "It is generally impossible to specifically trace the source of funds used for various corporate purposes and it was not the purpose of our proposed rule to do so"); Order No. 561-A, 59 FPC at 1341 (restating the preceding sentence from Order No. 561 and adding: "We recognize that short-term debt is a source of funds that can be used for many corporate purposes other than construction. However, short-term debt cost is a valid cost of conducting utility operations and a mechanism for the recovery of such cost should be provided for within the regulatory framework. Recovery of capital costs is usually provided for through the rate of return allowance in a general rate proceeding. However, in a typical rate case situation, the short-term debt cost does not lend itself to reasonable measurement for use in setting future rates because ... the amount of short-term debt that a company has outstanding can fluctuate widely over short periods of time. In addition, the interest rate for short-term debt often changes at frequent intervals. On the other hand, the cost of short-term debt can be effectively measured and capitalized, for subsequent recovery (through depreciation charges in rates) since under our formula the balances and rates for the forthcoming year are estimated annually, with appropriate adjustments to the amounts capitalized if the estimates used are not reflective of actual experience. Therefore, we do not believe that we should modify Order No. 561 with respect to the weight given short-term debt in the formula").

Dominion debt, whether long or short, passed to DETI as short-term borrowings.”²⁶² DETI argues that basing the AFUDC rate on the amount of short-term debt DETI possessed and the cost DETI paid on such debt would not be “reflective of the external sources of financing used to support DETI’s needs.”²⁶³ However, this methodology used by DETI is precisely the tracing of a regulated entity’s funds, rather than relying on the amount of short-term debt, and its cost, shown on the regulated entity’s books, that the Commission has rejected in the calculation of AFUDC.²⁶⁴ As required by the Commission’s regulations and precedent, the Audit Report appropriately relied on the amount and the cost of short-term debt on DETI’s books. What matters under GPI No. 3(17) are the costs to DETI of its short-term debt, not the costs to a parent or other entity of funds that allegedly became, i.e., have been traced to, DETI’s short-term debt. In applying a different structure or amount and different cost for short-term debt than reflected on DETI’s books, DETI departed from Commission regulations and precedent. DETI should have sought a waiver of Commission regulations and authorization for such a departure; although given Order Nos. 561 and 561-A’s “premise that all short-term debt should be allocated to financing construction work in progress, in order to establish a workable uniform formula to calculate a maximum AFUDC rate,”²⁶⁵ such a waiver request may not have been granted. Indeed, the Commission has held that engaging in the regulatory waiver and tracing that DETI is advocating here is “generally impossible.”²⁶⁶

²⁶² DETI Initial Memorandum at 10 (footnote omitted).

²⁶³ *Id.*

²⁶⁴ See *Otter Tail Power Co.*, 119 FERC ¶ 61,217 at PP 9-15 (holding, *inter alia*, that “it was not the intent of the [AFUDC] rule to try to trace the source of funds used for various corporate purposes”); *Tennessee Gas Pipeline Co.*, 64 FERC at 63,442 (stating that Order Nos. 561 and 561-A rejected “attempting to allocate short-term debt between construction and purposes other than construction (including non-utility purposes)”); *Minnesota Power & Light Co.*, Docket No. AC93-204-000 (Mar. 9, 1994) (delegated order) (rejecting MPL’s request for authorization to exclude from the Commission AFUDC formula that portion of its short-term debt used for its non-utility subsidiaries’ cash requirements).

²⁶⁵ *Tennessee Gas Pipeline Co.*, 64 FERC at 63,442.

²⁶⁶ *Id.* at 63,441-442 (“As the Commission stated in Order Nos. 561 and 561-A, it is generally impossible to specifically trace the source of funds used for various corporate purposes.”).

b. **DETI's Concern About Pipelines With 100 Percent Equity Financing**

122. DETI also argues that requiring pipelines to compute AFUDC using their book balances “could have perverse results” given that “[a] number of pipelines are financed by their parent companies and have an actual capital structure that is 100% equity.”²⁶⁷ DETI’s concern is that looking at the actual book balances of pipelines whose only financing is 100 percent equity financing from a parent entity would result in an AFUDC cost rate equal to the return on equity. However, the Commission has a stated policy that it is not permitted for AFUDC to ever exceed a pipeline’s approved rate of return on rate base.²⁶⁸ Such return therefore is a cap that would prevent a regulated utility with a 100 percent equity capital structure from having an AFUDC rate equaling the cost rate of equity. The “perverse result” DETI raises therefore is contrary to Commission policy, is not permitted to occur, and does not weigh against applying the Commission’s AFUDC formula as it is written and, as held above, was intended to be applied.

c. **DETI's Claim of an “Inconsistent Computation”**

123. DETI argues that using a pipeline’s own short-term debt and CWIP balances in the AFUDC formula but applying cost rates derived from its parent entity’s costs to value the pipeline’s preferred stock, long-term debt and equity book balances “results in an

²⁶⁷ DETI Initial Memorandum at 12.

²⁶⁸ See, e.g., *Trunkline Gas Co., LLC*, 135 FERC ¶ 61,019, at P 33 (2011) (“Consistent with Commission policy to design initial rates using a pipeline’s existing cost factors, it is also the Commission’s policy to limit the maximum amount of AFUDC that a pipeline could capitalize by limiting the AFUDC rate to a rate no higher than the overall rate of return underlying its recourse rates”); *Gulfstream Natural Gas System, L.L.C.*, 91 FERC ¶ 61,119, at 61,466 (2000) (stating in certificate proceeding involving new pipeline company building new, discrete project that pipeline company improperly calculated AFUDC using its 100 percent equity capital structure; AFUDC would be capped at the “overall rate of return on rate base”), *order on reh’g*, 94 FERC ¶ 61,119, at 61,637-38 (2001) (denying rehearing on AFUDC issue, noting that while Gulfstream is correct that “the Commission has prescribed a project financing approach for calculating AFUDC for some newly created entities,” Gulfstream “has not shown why it is reasonable ... to earn a higher rate of return during construction than the Commission would authorize [a regulated entity] to earn on an operating asset”), *order dismissing reh’g*, 95 FERC ¶ 61,100 (2001), *aff’d per curiam in unreported order*, *Gulfstream Natural Gas System, L.L.C. v. FERC*, 38 Fed. Appx. 24 (D.C. Cir. 2002) (affirming cap on AFUDC at rate of return, and observing that “the Commission required the same thing of Gulfstream as it has every other new pipeline to which it applied the project-finance approach”).

inconsistent computation.”²⁶⁹ DETI asserts that “once it is determined that the parent company’s capital structure is to be used, all of that entity’s book balances must be used, including the CWIP.”²⁷⁰

124. We find that DETI’s arguments misconstrue the Commission’s AFUDC regulations and, further, are not pertinent in this proceeding. First, as discussed above, the AFUDC regulations in GPI No. 3(17) do not require, call for, or permit a regulated entity to use “cost rates” derived from its parent entity to value the long-term debt and equity components of the formula for determining the maximum AFUDC rate permitted under GPI No. 3(17). The AFUDC regulations call for the regulated entity to use both its own cost rates and its own book balances for all the components in the maximum AFUDC rate formula in GPI No. 3(17). Additionally, audit staff’s finding and related recommendations do not call for any such “inconsistent calculation” in DETI’s case. It is undisputed that, throughout the relevant period, DETI’s short-term debt balances exceeded its CWIP balances. Therefore, under the maximum AFUDC rate formula in GPI No. 3(17), the maximum “cost rate” to be applied to DETI’s construction funds during the period of construction was solely its own cost rate for short-term debt. Neither the formula in GPI No. 3(17), nor audit staff’s finding, call for any application of the cost rates or book balances of DETI’s parent. In any event, this is not the appropriate proceeding in which to address DETI’s policy arguments about an alleged impropriety that would purportedly result from using cost rates derived from the regulated entity’s costs for some components of the maximum AFUDC rate formula in GPI No. 3(17) and using the parent entity’s cost rates for other components.

4. Alleged Selective and Arbitrary Enforcement

125. According to DETI, it is being singled out for not complying with a change in regulatory interpretation that has not been clearly announced and is not being applied to other regulated entities. We disagree with DETI’s claim of selective and arbitrary enforcement. An agency’s discretion not to exercise its enforcement authority or to exercise its enforcement authority in a particular way is within its absolute discretion.²⁷¹

²⁶⁹ DETI Reply Memorandum at 8.

²⁷⁰ *Id.* at 9.

²⁷¹ See *Vote Solar Initiative and Montana Environmental Information Center v. Montana Public Service Comm’n*, 158 FERC ¶ 61,032, at P 10 (2017) (citing *Heckler v. Chaney*, 470 U.S. 821, 831 (1985) (“[A]n agency’s decision not to prosecute or enforce, whether through civil or criminal process, is a decision generally committed to an agency’s absolute discretion”)); see also *Balt. Gas & Elec. Co. v. FERC*, 252 F.3d 456, 459 (D.C. Cir. 2001) (“Congress has not given the courts the power to hear challenges to an agency’s exercise of the discretion with which Congress has entrusted it”); *U.S. v.*

Moreover, to prove selective prosecution, one must show that (1) defendants were singled out while other similarly situated violators were left untouched; and (2) that the government selected the defendants for prosecution in bad faith based on impermissible considerations such as race, religion or the desire to prevent the exercise of constitutional rights (or a protected class).²⁷² DETI has not alleged or provided evidence of any facts showing that it was unfairly singled out, that there was bad intent or that it was part of a protected class.

126. Moreover, audit staff did not act in an arbitrary manner and is not enforcing a new policy against DETI that DETI alleges first appeared in a different company's 2014 audit report. Rather, the Audit Report in this proceeding is enforcing GPI No. 3(17), a promulgated regulation, which the Commission has previously reviewed and found to be "clear and explicit" about the inclusion of a regulated entity's actual short-term debt balance in GPI No. 3(17)'s formula, placing an obligation on a regulated entity to seek a waiver of that regulation in order to exclude its short-term debt when calculating AFUDC and thereby exceed the maximum rate produced by the GPI No. 3(17)'s formula.²⁷³ In at least three prior proceedings, as discussed above, a regulated entity was directed not to exclude or reduce its own short-term debt balances when calculating its AFUDC, because such actions resulted in AFUDC rates that exceeded the rates calculated using the formula in GPI No. 3(17).²⁷⁴

127. The evidence which DETI describes in support of its claim of selective or arbitrary enforcement of the relevant regulation, GPI No. 3(17) is unavailing. DETI asserts that the waivers granted its two Dominion affiliates show selective enforcement; however, those affiliates requested waivers while DETI did not and, more to the point, neither affiliate had any short-term debt and hence neither sought to exclude their own short-term debt balances, or to exceed the maximum AFUDC produced by GPI No. 3(17). DETI asserts that in 2015, audit staff examined the AFUDC calculations of a pipeline company

AT&T Inc., 290 F. Supp. 3d 1 (D.D.C. 2018) (defendant must put forward evidence of discriminatory effect and discriminatory intent).

²⁷² *U.S. v Smithfield Foods, Inc.*, 969 F. Supp 975, 984-85 (E.D. Va. 1997).

²⁷³ *Otter Tail Power Co.*, 119 FERC ¶ 61,217 at P 15 ("Finally, we emphasize that our regulations are clear and explicit that short-term debt should be included in the calculation of AFUDC rates It was and is Otter Tail's obligation to justify a departure, i.e., a waiver of those regulations and that policy, and Otter Tail Power did not and has not done so").

²⁷⁴ See *supra* PP 107-108 (discussing *Otter Tail Power Co.*, 119 FERC ¶ 61,217 and *Tennessee Gas Pipeline Co.*, 64 FERC ¶ 61,340; and *Minnesota Power & Light Co.*, Docket No. AC93-204-000 (Mar. 9, 1994) (delegated order)).

that “used its parent company’s capital structure” and yet did not find fault with it;²⁷⁵ however, there is no statement or other evidence in the 2015 audit report DETI references indicating that the pipeline company had short-term debt balances that it had excluded when calculating AFUDC. In fact, DETI has not identified a single proceeding or instance that presented the same act by another pipeline or utility that was accepted by audit staff or the Commission, nor has DETI presented any evidence that DETI has been singled out for an improper reason. We reject DETI’s argument that audit staff engaged in selective and arbitrary enforcement of GPI No. 3(17).

E. Whether The Audit Report’s Recommendation That DETI Restate Its Account Balances Prospectively Based On Recalculating Its AFUDC In Accordance With GPI No. 3(17) From 2008 to the Present Is “Fundamentally Unfair”

128. The Commission disagrees with DETI’s characterization of the Audit Report’s recommendation to correct DETI’s AFUDC accounting errors starting in 2008 as “fundamentally unfair.” As a preliminary matter, NGA section 8 grants to the Commission and its audit staff access to “all accounts, records, and memoranda,” of every regulated natural gas company, without any time limitation.²⁷⁶ Accordingly, when audit staff initiated the audit, it had the authority and discretion to initiate an audit covering a time period preceding the 2012 date set forth in the April 15, 2015 commencement letter. We note that the particular audit scope dates in an audit commencement letter identify audit staff’s planned testing period, but they do not limit the ability of the Commission or audit staff to have access to information or direct corrective action of accounting errors that occurred during a prior time period. Nor does an identified “audit period” limit the Commission’s authority under NGA section 16²⁷⁷ to perform any and all acts as it might find necessary or appropriate to carry out the processes of the NGA.

129. We find the Audit Reports’ direction to DETI to correct its incorrect AFUDC calculations to 2008 is justified. The incorrect AFUDC entries that DETI made in 2008

²⁷⁵ DETI Initial Memorandum at 17-18 (referencing *Natural Gas Pipeline Co. of America, LLC*, Docket No. PA13-5-000 (Oct. 30, 2015) (delegated order) .

²⁷⁶ 15 U.S.C. § 717g (2018) (“The Commission shall at all times have access to and the right to inspect and examine all accounts, records, and memoranda of natural-gas companies; and it shall be the duty of such natural-gas companies to furnish to the Commission, within such reasonable time as the Commission may order, any information with respect thereto ... and to grant to all agents of the Commission free access to its property and its accounts, records, and memoranda when requested so to do.”)

²⁷⁷ *Id.* § 717o.

and subsequent years had a cumulative effect on DETI's account balances that continues to distort DETI's current gas plant book balances. It is appropriate to require that DETI correctly state its gas plant book balances for purposes of ensuring accuracy in its accounting going forward. DETI's gas plant balances are used by the Commission, DETI's shippers, and other stakeholders to assess and determine the justness and reasonableness of its rates. Therefore, it is critical that those balances not reflect known errors that may skew ratemaking determinations regarding whether DETI's rates are just and reasonable. It would not be fair to DETI's rate-paying customers to fail to direct DETI to correct known accounting errors that are reflected in its current book balances.

130. As a further preliminary matter, we do not accept DETI's premise that a reasonable person would assume that neither the Commission nor its audit staff could, or would, ever impose a corrective action that took effect prior to the period for which documents were reviewed in an audit. DETI cites to no Commission orders, other agency orders, or case law suggesting that an agency or any other authority is prevented from taking corrective action based on the period of the documents it audits or reviews. Further, in numerous accounting orders issued by the Commission's audit staff, regulated entities have been directed to take corrective actions, including making refunds and recalculating account balances, relating to periods prior to the "audit period" identified in the audit commencement letter. That such an outcome was possible was widely known, further making any alleged contrary belief unreasonable.²⁷⁸

²⁷⁸ For example, in just the five years prior to the issuance, on April 15, 2015, of the audit commencement letter in this proceeding, corrective actions relating to periods prior to the stated "audit period" were imposed in at least thirteen proceedings. See *Kansas Gas and Electric Co.*, Docket No. FA14-3-000, Audit Report at 12, 14-17 (Mar. 27, 2015) (delegated order); *Union Electric Co.*, Docket No. FA13-2-000, at Audit Report at 37-38, 42, 44 (Mar. 27, 2015) (delegated order); *Southwestern Public Service Co.*, Docket No. FA13-4-000, at Audit Report at 33, 40 (Nov. 17, 2014) (delegated order); *Duquesne Light Co.*, Order Issuing Audit Report, Docket No. FA13-3-000, at Audit Report at 36-38 (Nov. 13, 2014) (delegated order); *Ruby Pipeline, LLC*, Docket No. FA13-12-000, at Audit Report at 19, 21 (Nov. 10, 2014) (delegated order); *PPL Corp.*, Docket No. FA12-12-000, Audit Report at 22-23 (Oct. 9, 2014) (delegated order); *San Diego Gas & Electric Co.*, Docket No. FA12-8-000 Audit Report at 11, 23, 26 (Recomm. No. 5) (June 10, 2014) (delegated order); *Idaho Power Co.*, Docket No. FA12-9-000, Audit Report at 11-12 (Dec. 11, 2013) (delegated order); *American Transmission Systems, Inc.*, Docket No. FA11-8-000, Audit Report at 10-14 (Apr. 24, 2013) (delegated order); *Niagara Mohawk Power Corp.*, Docket No. FA11-2-000, Audit Report at 22, n.12 (May 31, 2012) (delegated order); *Connecticut Light and Power Co.*, Docket No. FA11-15-000, Audit Report at 15 (May 31, 2012) (delegated order); *Interstate Power and Light Co.*, FA11-14-000, Audit Report at 6-7(Dec. 20, 2011) (delegated order); and *Vermont*

131. Even assuming, *arguendo*, that DETI had such understanding based on its receipt of the audit commencement letter, we do not find any unfairness. DETI's claim is, essentially, that it was "unfairly prejudiced" by a lack of notice in the audit commencement letter that a corrective action might result from the audit that affected its books prior to January 1, 2012.²⁷⁹ But, DETI does not explain how or why it was unfairly prejudiced. To successfully advance such a claim, however, it is incumbent on DETI to answer the question: what would it have done differently if it had notice – that is, if the audit commencement letter had contained an express reservation, stating that the upcoming audit might lead to a corrective action pre-dating the period for which documents were to be examined.²⁸⁰ DETI has not asserted, much less proven, that other courses of action were available to it upon receipt of the audit commencement letter and that, because of the alleged lack of notice and DETI's alleged, erroneous belief that no corrective action could have effect prior to January 1, 2012, DETI took, or refrained from taking, certain actions to its detriment. Accordingly, it is unclear what DETI might have done differently, or how it was in any way harmed by its alleged erroneous reading of the letter.

132. We also do not find DETI's claim of harm to the "investing public" to be reasonable under the circumstances here. The audit commencement letter in this case, and like those generally issued by the Commission's audit staff, detailed the areas to be reviewed in general terms. The audit commencement letters issued to regulated natural gas pipelines such as DETI routinely state that the audit will review the regulated entity's compliance with (1) its FERC Gas Tariff; (2) the accounting requirements in the Uniform System of Accounts Prescribed for Natural Gas Companies under 18 C.F.R. Part 201; and (3) the reporting requirements of the FERC Form No. 2, Annual Report; the audit commencement letter issued to DETI was no exception.²⁸¹

Transco LLC, Docket No. FA11-16-000, Audit Report at 9 (Dec. 8, 2011) (delegated order).

²⁷⁹ DETI Initial Memorandum at 21.

²⁸⁰ See, e.g., *Pub. Serv. Co. of Colorado v. FERC*, 91 F.3d 1478, 1490 (D.C. Cir. 1996) ("As we see the issue, the apparent lack of detrimental reliance on the part of the producers is the crucial point. What would they have done differently if they had known ..."); *New England Tel. & Tel. Co. v. FCC*, 826 F.2d 1101, 1110 (D.C. Cir. 1987) ("[P]etitioners have made no showing of detrimental reliance. Indeed, it is difficult to imagine how they might make such a showing.... Presumably, they would have behaved no differently had they clearly understood...").

²⁸¹ See DETI Audit Commencement Letter at 1 (stating "The audit will evaluate DTI's compliance with: (1) accounting regulations of the Uniform System of Accounts

133. Given the general nature of such description, even accepting *arguendo* DETI's assertion that investors would assume that no corrective action could or would predate the period for which documents would be reviewed, an assumption we reject, it appears unreasonable to presume that the investing public could derive any insight from the audit commencement letter regarding what financial impact, if any, DETI's audit might have. DETI asserts that "[a] sudden, unexpected reduction to a company's gas plant balance *beyond what was already noticed* [in the audit commencement letter] can harm the company's public image and valuation in a way that *foreseen changes* cannot."²⁸² But, the audit commencement letter did not provide any notice of a "reduction to [DETI's] gas plant balance," thus undermining DETI's assertion. An expected gas plant reduction of a sum certain could not have been a "foreseen change" based on anything said in the audit commencement letter. Nor, in fact, was anything said in the audit commencement letter that could enable the investing public to place a dollar value on what might be the result of the audit, or, similarly, place a dollar value on an alleged, erroneous belief that any eventual corrective action would not affect an accounting book balance entry made prior to January 1, 2012. Further, DETI's rates are largely the result of a 1998 settlement of DETI's last general NGA section 4 rate case and settlements approved by the Commission in five subsequent orders.²⁸³ These rates were designed (and approved by the Commission) to provide the pipeline with the opportunity to recover prudently incurred costs and provide a reasonable rate of return. Requiring DETI prospectively to adjust its accounting plant balances, as the Audit Report does, will not affect the rates currently in effect, nor require DETI to provide refunds to any customers. Rather, the effect of adjusting its account balances now will be to ensure that a correct plant balance will be reflected in the cost of service for purposes of developing just and reasonable rates as required by NGA sections 4 and 5.

134. We also do not find merit in DETI's speculation that audit staff's motive in adding a reservation of rights to some audit commencement letters issued subsequently to DETI's was audit staff's awareness of the "fundamental[] unfair[ness]" of requiring the correction of accounting errors made prior to the "audit period" referenced in a commencement letter. Given the absence of harm and lack of unfairness from correcting

under 18 C.F.R. Part 201; (2) reporting requirements of the FERC Form No. 2, Annual Report, under 18 C.F.R. § 260.1; and (3) DTI's FERC gas tariff").

²⁸² DETI Initial Memorandum at 21 (emphasis added).

²⁸³ See *Dominion Transmission, Inc.*, 146 FERC ¶ 61,068 (2014); *Dominion Transmission, Inc.*, 111 FERC ¶ 61,285 (2005); *Dominion Transmission, Inc.*, 96 FERC ¶ 61,288 (2001); *Dominion Transmission, Inc.*, 95 FERC ¶ 61,316 (2001); *CNG Transmission Corp.*, 89 FERC ¶ 61,304 (1999); *CNG Transmission Corp.*, 85 FERC ¶ 61,261 (1998).

accounting errors arising prior to the particular “audit period” referenced in a commencement letter, and audit staff’s frequent practice of requiring just such corrections, a more plausible explanation would be a desire simply to preempt any claims of reliance on the “audit period” such as we have just reviewed and rejected.

F. Whether the Requirement to Correct AFUDC Accounting Balances Since 2008 Is Barred By the General Federal Statute of Limitations

135. The general, federal five-year statute of limitations states as follows:

Except as otherwise provided by Act of Congress, an action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise, shall not be entertained unless commenced within five years from the date when the claim first accrued if, within the same period, the offender or the property is found within the United States in order that proper service may be made thereon.²⁸⁴

136. In *Kokesh*,²⁸⁵ the U.S. Supreme Court held that this general, five-year statute of limitations applies to “claims for disgorgement imposed as a sanction for violating a federal securities law.”²⁸⁶ The Supreme Court held that “disgorgement” as that sanction is applied in the securities-enforcement context constituted a “penalty” as that term is used in the federal five-year statute of limitations because (1) disgorgement was a remedy being imposed by the courts for violations of public laws where the offense was against the United States rather than an aggrieved individual, and (2) disgorgement in the SEC context was being imposed by the courts for punitive and retributive purposes – that is, to act as a deterrent, rather than for remedial or compensatory purposes – in particular, “deterrence [was] not simply an incidental effect of disgorgement. Rather, courts [had] consistently held that ‘[t]he primary purpose of disgorgement orders is to deter violations of the securities laws by depriving violators of their ill-gotten gains.’”²⁸⁷

137. As noted above, DETI argues that the corrective actions recommended by audit staff constitute a “penalty” and a “forfeiture” under the general federal statute of limitations because, DETI claims, they meet both parts of the two-pronged test for a

²⁸⁴ 28 U.S.C. § 2462 (2018).

²⁸⁵ 137 S.Ct. 1635 (2017).

²⁸⁶ *Id.* at 1639.

²⁸⁷ *Id.* at 1643 (quoting *SEC v. Fischbach Corp.*, 133 F.3d 170, 175 (2d Cir. 1997)).

penalty discussed in *Kokesh*. DETI argues both that the corrective actions “redress wrongs to the public, rather than specific individuals,” and that they are punitive, not remedial.²⁸⁸

138. We reject both these contentions. With respect to the first, the corrective recommendations are not for the purpose of “redressing” a past wrong, whether characterized as a “wrong” to the public or to an individual, but for the purpose of preventing future unjust and unreasonable rates and charges that would fall on individual members of the public. The Audit Report did not recommend, and we are not ordering, disgorgement. The corrected accounting balances resulting from the corrective recommendations are to be applied prospectively, with all of the benefit or result of these corrected account balances being realized as just and reasonable rates being paid by ratepayers. These circumstances do not fit with the first prong of the penalty test, which describes a backwards looking action taken to “redress” a past wrong done to either an individual or the public/United States, with proceeds (i.e., the penalty) collected from a wrongdoer going in whole or large part to the United States. In short, audit staff’s recommended corrective actions would benefit future individual private persons/ratepayers, by preventing them from paying unjust and unreasonable rates.

139. Turning to the second prong, DETI contends that the corrective recommendations are a “punishment” because their clear purpose is “deterrence” as they are “clearly intended to deter certain behavior.” In support, DETI repeats arguments that we have rejected above, to wit: (1) the Audit Report (and presumably Commission affirmance of the Audit Report) is focused on DETI’s failure to request permission “to compute AFUDC using its parent company’s book value [sic];” (2) “Audit Staff focuses on the company’s failure to obtain its approval, rather than the validity of the accounting method itself;” (3) waivers were granted to DETI’s two affiliates, which did exactly what DETI did; (4) audit staff disregards “overwhelming Commission precedent” requiring DETI to do what it did; (5) audit staff disregards “DETI’s transparent 30-year practice;” and (6) audit staff cannot object “to the merits” of what DETI did.²⁸⁹ Based on the foregoing claims, DETI asserts that “Audit Staff appears to be using the finding and recommendations as a means to deter

²⁸⁸ See DETI’s Initial Memorandum at 23-25; DETI Reply Memorandum at 12 (stating “As DETI showed in its Initial Memorandum, Audit Staff’s proposed sanction is a penalty because it is (1) imposed to address a wrong committed onto the public, as opposed to an individual, and (2) that [sic] is punitive or is made ‘for the purpose of punishment’ and to deter, ‘as opposed to compensating a victim for his loss.’”) (citing DETI’s Initial Memorandum at 23, and quoting *Kokesh v. SEC*, 137 S.Ct. at 1642)).

²⁸⁹ DETI Initial Memorandum at 24.

DETI and others from not seeking explicit approvals from the Commission, despite clear Commission precedent to the contrary.”²⁹⁰

140. In this order, we reject all of these contentions, finding that what DETI did violates the explicit and specific terms of the Commission’s regulations, and hence DETI is incorrect in arguing that what DETI did accords with Commission policy and precedent, or that the corrective recommendations in the Audit Report arose because DETI simply failed to get advance permission to do what otherwise accords with Commission policy and precedent. We also find, as discussed above, that DETI’s case differs substantially from that of its two affiliates, neither of which had short-term debt, and therefore neither excluded short-term debt financing that exceeded its CWIP. As also discussed above, it was not “transparent” from DETI’s FERC Form No. 2 filings or from data responses it provided in a 2004 audit that DETI was exceeding the maximum rate calculated under GPI No. 3(17), or that DETI had a “methodology” that would entail DETI, despite its own short-term debt exceeding its CWIP, applying long-term financing rates in the calculation of its AFUDC that would cause it to exceed the maximum rate prescribed in GPI No. 3(17).

141. DETI further contends that the proposed corrective recommendations are a “penalty” and a “forfeiture” because they would leave DETI “worse off” than had it not violated GPI No. 3(17). In support of this claim, DETI asserts that it will be “worse off” because “DETI would lose the ability to recover or earn a return on the funds invested.”²⁹¹ Additionally, DETI states: “[T]he Commission will leave DETI unable to earn a return of or on its investment,”²⁹² “[t]he Commission ... would deprive DETI of the ability to recover the investment it has already made,”²⁹³ “Audit Staff seeks to strip DETI of its right to recover and earn a return on funds it has invested in the regulated facilities, on the grounds that DETI incorrectly accounted for these funds dating back to 2008,”²⁹⁴ and DETI has lost its right “to have an opportunity to earn a reasonable return on its investment, due to its ‘breach of obligation’ to properly account for its expenses.”²⁹⁵

²⁹⁰ *Id.*

²⁹¹ *Id.* at 25.

²⁹² *Id.*

²⁹³ *Id.* at 25-26.

²⁹⁴ *Id.* at 26.

²⁹⁵ *Id.*

142. DETI's claim that it is losing its right both to recover funds invested in facilities and also obtain a reasonable return forms the basis of its claim that the corrective recommendations are "punitive" and a "punishment." However, DETI's factual claim is demonstrably false.

143. DETI has not demonstrated that the corrective recommendations have an impact on its right or ability to recover the funds that it invested in facilities. We note that all funds, which constitute CWIP, were permitted to be included in DETI's Account No. 107, Construction Work in Progress – Gas, when DETI incurred such costs, and then were permitted to be transferred to DETI's account for plant in service (Account No. 101, Gas Plant in Service) when its jurisdictional facilities were placed in service, and these investment costs have been or are being recovered through depreciation, with an allowed return on such funds at DETI's long-term financing rate of return until they are recovered through depreciation. Nothing in this proceeding, including the corrective recommendations, impacts that process. DETI's assertion that its right to recover its actual investment in construction would be impacted or denied by the Audit Report's finding is refuted by decades-old Commission accounting regulations, similar for both gas and electric regulated utilities, that permitted DETI immediately to place its investment/construction costs, when incurred, into Account No. 107 (CWIP) and then transfer them when its facilities went into service to Account No. 101 (gas plant in service) to be recovered through depreciation.²⁹⁶

²⁹⁶ See, e.g., *Central Illinois Light Co.*, 10 FERC ¶ 61,248, at 61,477 ("While plant is under construction, the costs of construction are carried in a non-rate base account, Construction Work in Progress (CWIP) (Account 107). AFUDC is included in this account as one cost of construction. Once the completed facilities are placed in service, the amounts in the CWIP account are transferred to the Plant in Service Account (Account 101), which is a rate base account. The company thereafter may recover the cost of the facilities, through depreciation, and a return thereon, over the life of the facilities"); *Northern Border Pipeline Co.*, 80 FERC ¶ 61,150, at 61,616 (1997) (accepting Northern Border's representation "that it will enter the [construction] costs into Account No. 107 (Construction Work in Progress-Gas) when incurred, but will only reflect those costs in rate base when the project goes into service."); *Florida Gas Transmission Co.*, 88 FERC ¶ 61,142, at 61,473 (1999) ("The Commission's accounting regulations require that costs recorded in Account 107, Construction Work in Progress-Gas, be transferred to Account 101, Gas Plant in Service, upon completion of construction. At that time AFUDC accrual ceases, depreciation begins, and the costs of operating the pipeline together with related revenues are included in net income. Florida Gas will be required to conform its accounting during the ramp-up period to these USofA requirements."); *Tallgrass Interstate Gas Transmission, LLC*, 114 FERC ¶ 61,197, at 62,102 (2013) ("gas plant in process of construction is to be recorded in Account 107,

144. We also disagree that DETI is losing the opportunity to recover a reasonable return on those invested funds. The effect of the corrective recommendations is to give DETI a “return on,” or the time-value of (i.e., AFUDC), construction funds equal to the return on, or time-value of, its short-term debt for the period of construction, as required by GPI No. 3(17), rather than the higher, inflated return on or time-value that DETI calculated for the period of construction, which exceeded the maximum rate prescribed in GPI No. 3(17). DETI is therefore being permitted a reasonable return on, or time-value of, its funds (i.e., the maximum such return permitted by GPI No. 3(17)) during the period of construction. Further, once the jurisdictional facilities DETI constructed are, or were, placed in service, the “return on” or time-value of funds that has accrued during the period of construction is capitalized (as are the construction expenses) by being placed in DETI’s plant in service account, and this capitalized AFUDC is recovered through depreciation and earns a return until recovered.

145. Moreover, the Audit Report’s recommendations are that the corrected account balances be applied only prospectively. Hence, DETI is returned to the position it should be in on a *prospective* basis only. No requirement is imposed on DETI to apply the corrected account balances to its rates, charges or other actions in prior periods, to make restitution or refunds, or to pay any penalty or disgorgement, for any excess rates or charges received in past periods based on its incorrect accounting. Rather, the corrective recommendations will result in DETI operating with the correct account balances prospectively, so that once DETI’s rates again become the subject of a rate case in the future, individuals paying DETI’s future rates and charges will be protected from unjust and unreasonable charges.²⁹⁷ In this way, the corrective recommendations are entirely remedial.

146. For the foregoing reasons, we find that the corrective recommendations do not leave DETI “worse off” than it would be had it complied with the maximum AFUDC rate

Construction Work in Progress - Gas, under the Commission’s accounting regulations, as required by Gas Plant Instruction (GPI) No. 3.”), *order vacating certificate in part*, 148 FERC ¶ 61,003 (2014).

²⁹⁷ We note that this structure (i.e., a correction to account balances covering prior years but prospective application only of the corrected balances) was proposed by a regulated entity in a prior proceeding, involving a failure to account for short-term debt balances when calculating AFUDC, as being a favored alternative remedy to requiring refunds or other measures intended to redress prior wrongs. *See Otter Tail Power Co.*, 119 FERC ¶ 61,217 at PP 16-19 (discussing Otter Tail’s “plea in the alternative” that it be allowed to revise its account balances “to reflect the use of the revised AFUDC rate for past periods” but that the revised balances “be given prospective effect” starting from the January 12, 2007 date of audit staff’s letter order so as to “avoid making any retroactive adjustments” to rates).

calculated by GPI No. 3(17). The corrective recommendations return DETI's plant-in-service account balances, and therefore DETI, to the place DETI would be in going forward – i.e., on a prospective basis from November 8, 2017, the date the Director of the Office of Enforcement issued a delegated letter order approving the uncontested audit findings and recommendations, had DETI used the maximum AFUDC rate permitted by GPI No. 3(17) rather than exceeding that rate. The corrective recommendations are purely “remedial,” have only a prospective impact, return DETI's account balances to the position the balances would be in had DETI not exceeded the formula in GPI No. 3(17) from 2008 to the present, and thus are not punitive.

147. For the reasons discussed above, we find that this case is distinguishable from *Kokesh*, where disgorgement was found to sometimes involve noncompensatory payments imposed as a punishment for past prior unlawful actions, and “it [was] not clear that disgorgement, as . . . applied . . . in the SEC enforcement context, simply returns the

defendant to the place he would have occupied”²⁹⁸ Rather, this case involves correcting a regulated entity’s accounting books to bring them into compliance with Commission accounting regulations, thereby prospectively protecting the rights of private parties – i.e., ratepaying customers²⁹⁹ from paying excessive charges. We therefore reject DETI’s assertions that the corrective recommendations constitute “penalties” or “forfeitures” under *Kokesh* and reject its assertion that the general federal five-year statute of limitations applies to the corrective recommendations or this proceeding.

148. While, for the foregoing reasons, we do not believe the statute of limitations applies, assuming *arguendo* that it did, we would nonetheless reject DETI’s assertion that the statute’s five-year period commences upon what DETI refers to as “recordation.” DETI’s maintenance of improper account balances that violate the Commission’s accounting regulations found in the Uniform System of Accounts is an ongoing or present, recurring violation,³⁰⁰ making this action seeking to have DETI correct its account balances for prospective application a timely action.

The Commission orders:

(A) Finding No. 1 of the Audit Report and related recommendations 1, 2, 4, and 5, upon review as discussed in the body of this order, are hereby affirmed in their entirety.

²⁹⁸ *Kokesh*, 137 S.Ct. at 1644 (finding that “SEC disgorgement . . . bears all the hallmarks of a penalty: [i]t is imposed as a consequence of violating a public law and it is intended to deter, not to compensate”).

²⁹⁹ *See Meeker v. Lehigh Valley R. Co.*, 236 U.S. 412, 423 (holding that five-year federal statute of limitations does not apply to Interstate Commerce Commission refund orders and distinguishing “something imposed in a punitive way for an infraction of a public law” from “a liability imposed solely for the purpose of redressing a private injury, even though the wrongful act be a public offense, and punishable as such”); *Gulf Oil Corp.*, 56 FPC 3492 (1976) (citing *Meeker* and holding that refund orders were not subject to § 2462 because refunds are “designed not as a penalty but as the means of having [customer] and consumers in approximately the same position they would have been in”).

³⁰⁰ *See, e.g.*, 15 U.S.C. § 717g (2018) (“Every natural gas company shall make, keep, and preserve . . . such accounts . . . as the Commission may by rules and regulations prescribe as necessary or appropriate for purposes of the administration of this chapter”).

(B) DETI is hereby directed to comply with recommendations 1 and 2, which pertain to policies, procedures and training, within 30 days from the date of this order, and submit to DAA copies of any written policies and procedures developed in response to recommendations 1 and 2.

(C) DETI is hereby directed to provide to audit staff the yearly estimate(s) described in recommendation 4 and otherwise fully comply with recommendation 4 within 180 days from the date of this order, and upon subsequently receiving DAA's assessment of DETI's proposed accounting changes, comply with recommendation 5.

By the Commission. Commissioner Clements is not participating.

(S E A L)

Kimberly D. Bose,
Secretary.