SUPREME COURT OF NORTH CAROLINA

STATE OF NORTH CAROLINA EX )
REL. UTILITIES COMMISSION; )
DUKE ENERGY CAROLINAS, LLC, )
Applicant; PUBLIC STAFF- )
NORTH CAROLINA UTILITIES )
COMMISSION, Intervenor, )
) From the North Carolina
Appellees, ) Utilities Commission (207)
) Docket No. E-7, SUB989
v. )
)
ATTORNEY GENERAL ROY COOPER, )
Intervenor, and THE CITY OF DURHAM, )
NORTH CAROLINA, Intervenor, )
) Appellants.
)

********************************************
BRIEF AMICUS CURIAE OF AARP IN SUPPORT OF APPELLANT
NORTH CAROLINA ATTORNEY GENERAL
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STATEMENT OF INTEREST OF AARP

AARP is a nonprofit, nonpartisan organization with a membership that helps people 50+ have independence, choice, and control in ways that are beneficial and affordable to them and society as a whole. AARP is greatly concerned that older consumers will be detrimentally impacted by the electric utility rate increase at issue in this appeal.

Reasonable utility rates and service are essential for older people’s health and financial wellbeing. Older people living on low or fixed incomes are most vulnerable to high utility costs and may be forced to reduce expenditures on other basic needs, including food and medicine, or to reduce their levels of heating and cooling beyond safe levels. Older people disproportionately suffer from certain medical conditions which make them especially sensitive to temperature extremes, such as diabetes, lung disease, and heart disease. High utility costs also threaten their ability to continue to live independently, forcing some into nursing homes prematurely or even into homelessness.

One component of the $309,033,000 (7.21%) annual increase in electric rates awarded by the North Carolina Utilities Commission (“NCUC” or “Commission,”) includes a 10.5% profit (rate of return on common equity, or “ROE”) for Duke Energy Carolinas, LLC (“Duke” or “Company”). NCUC Docket No. E-7, SUB 989, Order Granting General Rate Increase (“Order”), January 27,
2012, 25-32, 66. This 10.5% ROE is considerably out of step with the economic conditions in North Carolina, resulting in rates that are unreasonable and unfair to ratepayers, particularly older and low income consumers.

AARP advocates in states across the country to protect older consumers from unnecessarily high utility costs. In 2011 alone, AARP advocacy in utility rate cases saved 17,866,897 people aged 50+ $572,768,174 in excess utility charges. AARP’s participation as amicus curiae in this appeal will assist this Court in evaluating whether the Commission has met its statutory obligation to fairly balance the interests of energy consumers and utility investors considering the evidence presented and the realities of the current struggling economy.

**STATEMENT OF FACTS**

_Amicus curiae_ AARP adopts the Statement of Facts provided in the Appellant North Carolina Attorney General’s Initial Brief.

**SUMMARY OF ARGUMENT**

The Commission correctly recognizes that it must consider current economic conditions when it sets rates pursuant to N.C.G.S. § 62-133(b)(4). It even mentions that the record contains some evidence of the economic impact on consumers. The Commission never provides an explanation, however, of how it took such evidence into account in awarding Duke a 10.5% ROE. It merely adopted a non-unanimous settlement which provides for the 10.5% ROE. The
Commission’s failure to explain specifically how it considered the evidence of the impact of current economic conditions in concluding that the 10.5% ROE is reasonable is reversible error.

Additionally, no filed testimony specifically supports a 10.5% ROE. The testimony given at the hearing in support of this level of profit was given in the context of support for the overall settlement, which combined other rate case issues. Because the Commission lacked competent, material, and substantial evidence to support a 10.5% ROE, the order is arbitrary and capricious, and otherwise not in accordance with law.

In fact, a 10.5% ROE is unjust and unreasonable under current economic conditions and will significantly harm older and low income rate-paying customers. This Court should remand this matter for a determination that considers current economic conditions and is as fair to consumers as it is to Duke.

ARGUMENT

I. THE COMMISSION FAILED TO MEET ITS STATUTORY OBLIGATION TO MAKE SPECIFIC FINDINGS REGARDING THE ECONOMIC IMPACT ON CONSUMERS.

As the Commission acknowledges in its order, it “is required to consider the economic effects of its ROE decision on a public utility’s customers pursuant to G.S. § 62-133(b)(4).” Order at 28. The Commission is statutorily obligated to fix the ROE such that it “will enable the public utility by sound management to
produce a fair return for its shareholders, *considering changing economic conditions* and other factors . . . and to compete in the market for capital funds on terms that are *reasonable and that are fair to its customers* and to its existing investors.” *Id.* (emphasis added).

Commission orders must include “findings and conclusions and the reasons or bases therefore upon all the material issues of fact, law, or discretion presented in the record,” N.C.G.S. § 62-79(a)(1), and be set forth in “sufficient detail to enable the court on appeal to determine the controverted questions presented in the proceedings.” N.C.G.S. § 62-79(a). The Commission is required “to find all facts essential to a determination of the question at issues.” *State ex rel. Util. Comm’n v. Eddleman*, 320 N.C. 344, 351, 358 S.E.2d 339, 345 (1987) (quoting *State ex rel. Util. Comm’n v. Haywood Elec. Membership Corp.*, 260 N.C. 59, 64, 131 S.E.2d 865, 868 (1963)).

The economic impact on consumers is an essential and material fact which must be addressed specifically by the Commission in fixing ROE. *State ex rel. Util. Comm’n v. Pub. Staff (“Pub Staff”),* 323 N.C. 344, 481, 494, 374 S.E.2d 368 (1988). ROE is of the utmost importance in an electric rate case because of its impact on ratepayers:

The proper rate of return on common equity is here an extremely important determination because, as can be seen, it is the most expensive form of capital accumulation, which expense is ultimately borne by the ratepayer, and it is the most heavily weighted in
arriving at the overall return. It is important that a reviewing court be able to determine the factual underpinnings upon which the Commission’s conclusion on this rate of return rests.

State ex rel. Util. Comm’n v. Pub. Staff (“Duke Power I”), 322 N.C. 689, 697-98, 370 S.E.2d 567, 572-3 (1988) (finding violation of N.C.G.S. § 62-79(a) when a rate increase order failed “to make specific findings showing what effect, if any, it gave to financing costs . . . in arriving at its common equity rate of return decision.”). The Commission’s failure to include all necessary findings of fact on the economic effect of the ROE on consumers is an error of law and a basis for remand. See Pub. Staff, 323 N.C. at 496, 374 S.E.2d at 369.

A. The Commission’s failure to make detailed findings regarding the economic impact on consumers of a 10.5% ROE is reversible error.

The Commission failed to meet its statutory obligation to make detailed findings explaining how it evaluated the essential and material facts of economic impact to establish the overall ROE. See Eddleman, 320 N.C. at 351, 358 S.E.2d at 345; Pub. Staff, 323 N.C. at 494, 374 S.E.2d at 368. Instead, it merely references generally the testimony, stating:

Public Staff witness Johnson testified in depth concerning the economic downturn, including the unemployment rate. In addition, the Commission received extensive testimony from public witnesses concerning the impact of current economic conditions on Duke’s customers. Therefore, the Commission has ample evidence to consider in determining whether the proposed ROE of 10.5% is fair to Duke’s customers.
Order at 28. The Commission’s statement that ample evidence exists is devoid of any explanation describing how it arrived at its conclusion that 10.5% is fair to Duke’s customers.

For example, it is impossible to discern whether the aforementioned evidence of economic hardship was rejected by the Commission as unbelievable, or whether that same evidence was found believable and actually weighed in some manner by the Commission in arriving at the conclusion that 10.5% ROE is reasonable and fair.

At a minimum, the Commission must make a finding regarding economic impact that is sufficiently detailed to indicate whether the evidence was viewed either favorably or unfavorably. See Pub. Staff, 323 N.C. at 497, 374 S.E.2d at 370, Duke Power I, 322 N.C. at 701, 370 S.E.2d at 574.

By failing to provide the necessary factual findings to support its reasoning, the Commission has “frustrated” this Court’s appellate review and committed reversible error. See Pub. Staff, 323 N.C. at 496, 374 S.E.2d at 369; Duke Power I, 322 N.C. at 699, 370 S.E.2d at 573 (quoting State ex rel. Utilities Comm. v. Public Staff, 317 N.C. 26, 34, 343 S.E.2d 898, 904 (1986)). In Duke Power I, also involving a challenge to a Commission ROE award, this Court held that the Commission failed to meet its statutory obligation pursuant to N.C.G.S. § 62-79(a)
because it did not include material factual findings sufficient in detail to permit meaningful appellate review. The Court’s instruction is highly apposite here:

What constitutes a fair rate of return on equity . . . is ultimately a matter of judgment. Matters of judgment are not factual; they are conclusory and based ultimately on various factual considerations. . . What constitutes a fair rate of return on common equity is a conclusion of law which must, in turn, be predicated on adequate factual findings.

_Duke Power I, 322 N.C. at 693, 370 S.E.2d at 570._

Indeed, the conflicting testimony in this case brings into sharp relief the importance of findings explaining how the Commission weighed evidence of the economic impact on consumers in fixing ROE. Duke requested 11.5% ROE, whereas the Public Staff recommended 9.25% ROE. Order at 30. This disagreement over 225 basis points put $213,299,000 at stake for North Carolina electric consumers on an annual basis. AARP estimates that the difference between the recommended 9.25% ROE and the 10.5% ROE awarded by the Commission is worth more than $100,000,000 a year—money which consumers could instead use to meet their basic necessities, pay off debt, save for retirement, or spend in ways that stimulate the North Carolina economy.
B. The Commission’s adoption of the non-unanimous settlement does not satisfy its statutory obligation to make detailed findings regarding economic impact of the ROE on consumers.

The Commission Order extols the virtues of the non-unanimous settlement reached between Duke, Public Staff, and Time Warner. Order at 31. But accepting the settlement without making independent findings regarding the economic impact on consumers is an abdication of its statutory obligation. State ex rel. Util. Comm’n v. Carolina Util. Customers Ass’n, Inc. (“CUCA”), 348 N.C. 452, 465, 500 S.E.2d 693, 703 (1998). In CUCA, this Court rejected the Commission’s “wholesale” adoption of a non-unanimous settlement “without analysis or deduction.” Id., 348 N.C. at 467, 500 S.E.2d at 703. CUCA found:

[Chapter 62] contemplates a full and fair examination of evidence put forth by all of the parties. To allow the Commission to dispose of a contested rate case by stipulation of less than all certified parties would effectively absolve the Commission of its statutory and due process obligations to afford all parties a fair hearing.

Id., 348 N.C. at 463, 500 S.E.2d at 701.

Thus, the Commission may adopt the recommendations or provisions of a non-unanimous settlement only if it “‘makes an independent finding supported by ‘substantial evidence on the record as a whole’ that the proposal will establish ‘just and reasonable’ rates for the area.’” Id., 348 N.C. at 465, 500 S.E.2d at 703 (quoting Mobil Oil Corp. v. FPC, 417 U.S. 283, 314 (1974)) (remanding order after finding Commission’s conclusion about ROE came directly from non-
unanimous stipulation without providing any reason or analysis). “[E]ach link in the chain of reasoning must appear in the order itself.” *Eddelman*, 320 N.C. at 352, 358 S.E.2d at 346 (quoting *Coble v. Coble*, 300 N.C. 708, 714, 268 S.E.2d 185, 190 (1980)).

Here, the Commission accepted the non-unanimous settlement without considering “all other evidence presented by any of the parties” regarding the proper ROE. *CUCA*, 348 N.C. at 466, 500 S.E.2d at 703. This Court has previously rejected such Commission action and should do so here. *Id.* (finding “Where the Commission failed to adduce ‘its own independent conclusion’ as to the appropriate rate of return on equity, [ ] [the] case must be remanded to the Commission.”) (quoting *State ex rel. Util. Comm’n v. State*, 239 N.C. 333, 344, 80 S.E.2d 133, 141 (1954)). This case should be remanded to the Commission to make specific findings regarding the proper ROE considering the impact of the economic conditions on ratepayers.

II. THE ORDER AUTHORIZING A 10.5% ROE IS ARBITRARY AND CAPRICIOUS AND UNSUPPORTED BY COMPETENT AND SUBSTANTIAL EVIDENCE OF THE IMPACT OF ECONOMIC CONDITIONS ON CONSUMERS.

In addition to making detailed findings about all material facts, the Commission is also statutorily required to support its detailed findings and conclusions by “competent, material, and substantial evidence in view of the entire record as submitted.” N.C.G.S. § 62-94(b)(5). Substantial evidence has been
defined as “more than a scintilla or a permissible inference.” *Util. Comm’n v. Trucking Co.*, 223 N.C. 687, 690, 28 S.E.2d 201, 203 (1943). Such findings must not be arbitrary or capricious or affected by other errors of law. N.C.G.S. § 62-94(b)(6). The Commission Order setting a 10.5% ROE is arbitrary and capricious because the evidence does not support it.

A. **No specific evidence regarding the impact of changing economic conditions on consumers supports a 10.5% ROE.**

The record as a whole does not support a finding that 10.5% ROE is “reasonable” and “fair” to consumers, especially in light of current economic conditions. Three “cost of capital” expert witnesses testified on behalf of Duke regarding the proper ROE to use in the calculation of electric rates, involving of hundreds of pages of written testimony and transcripts of cross-examination. None of that testimony addresses the impact of “changing economic conditions” on consumers. None of the witnesses incorporated consumer economic data into their analysis, much less supplied data for the record relating to the impact of awarding a 10.5% ROE on the wellbeing of consumers living on fixed or low income. As in *CUCA*, no ROE-specific testimony was filed specifically supporting a 10.5% ROE, and the only testimony given at the hearing in support of this level of profit was taken in the context of a non-unanimous settlement that combined ROE with other unrelated rate case issues. *See* Order at 28.
The Commission references the lay testimony of public witnesses with respect to the economic impact finding required by N.C.G.S. § 62-133(b)(4), but completely fails to discuss that testimony. The overwhelming majority of lay public hearing testimony opposed any additional rate increase and relayed several stories of economic hardship during the currently difficult economic times.

Just as the Commission’s praise for the non-unanimous settlement does not satisfy the Commission’s statutory obligations to make detailed findings, the Commission’s wholesale adoption of the settlement does not satisfy the requirement that the ROE be supported by “competent, material, and substantial” evidentiary support. See CUCA, 348 N.C. at 467, 500 S.E.2d at 703.

B. Approving a ROE that is higher than necessary to permit the utility to participate in the capital markets violates North Carolina law and harms consumers.

Requiring rate payers annually to pay $100,000,000 more than reasonably necessary is unfair and violates North Carolina law. This Court has found that the North Carolina legislature intended for the Commission to set utility rates as low as reasonably consistent with due process requirements of the Fourteenth Amendment to the U.S. Constitution and Article 1, §19 of the N.C. Constitution. Duke Power I, 322 N.C. at 697, 370 S.E.2d at 572. “By long standing usage in the field of rate regulation, the ‘lowest reasonable rate’ is one which is not confiscatory in the constitutional sense.” FPC v. Natural Gas Pipeline Co., 315 U.S. 575, 585 (1942).
In North Carolina this requirement has been interpreted to mean that “[a utility] is not entitled to charge . . . rates which will make its shares . . . attractive to investors who are willing to risk substantial loss of principal in return for the possibility of abnormally high earnings.” *Duke Power I*, 322 N.C. at 699-700, 370 S.E.2d at 573-574 (emphasis added). In other words, to balance the interests of consumers and investors, the ROE must be set sufficiently high to permit the utility to participate in the capital markets, but not higher. *Id.* Whether the earnings are abnormally high must be evaluated in accordance with the statutory requirements.

Setting an overly high ROE erodes the assurance that a consumer will pay a reasonable rate for electricity, harming vulnerable consumers. *See* F. Scott Hempling, *Low Rates, High Rates, Wrong Rates, Right Rates*, NRRI (Jan. 14, 2009).1 It can also hamper economic growth because electricity costs eat into the bottom line of every product produced and service provided. *Id.* Additionally, overly-high ROE has been criticized by utility regulation experts because it provides too much cushion for poor management decisions and insufficient incentive for utilities to maintain consistently high-quality service. *Id.*

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1 Available at http://www.nrri.org/web/guest/monthly-essays- detail?p_p_id=33&p_p_lifecycle=0&p_p_col_id=column-1&p_p_col_pos=1&p_p_col_count=2&_33_struts_action=%2Fblogs%2Fview_entry&_33_redirect=351516&33_linkFullViewPager=351516&33_linkListViewPage=351442&p_r_p_564233524_displayDateFrom=&p_r_p_564233524_displayDateTo=&33_cur=10&33_entryId=349505.
Experts have developed an economic model known as the Averch-Johnson Effect showing that an overly-attractive rate of return could encourage excessive or risky investment in construction of new power plants, driven largely by investor demand for profits rather than consumer demand for reasonable amounts of electricity at reasonable rates. See H. Averch & L. Johnson, *The Behavior of the Firm Under Regulatory Constraint*, 52 Am. Economic Rev. 1052 (1962)\(^2\) (illustrating mathematically that public regulation creates an incentive for the firm to over-invest in tangible assets, because the “allowed profit” is based on the rate base which is increased by augmenting its capital stock). While older generating plants, which may be fully or mostly depreciated, will not continue to generate ROE for investors, construction of new power plants will return a handsome profit. Therefore, investors will demand new investment to drive profit growth, particularly if the approved ROE is high. See Edward Malley & David Zarider, *Decommissioning Obsolete Power Plants—Why do it Now?*, Energy Pulse (June 16, 2011).\(^3\)

Maintenance of existing generating facilities or selection of lower cost options—including greater energy efficiency and development of renewable energy sources—can assist to keep rates low and reduce demand, thereby

\(^2\) Available at http://www.jstor.org/stable/1812181.

\(^3\) Available at http://www.energypulse.net/centers/article/article_display.cfm?a_id=2433.
forestalling the need to construct more power plants. But investment in construction of new plants will lead to higher profits, whether or not demand justifies the investment. The typical rules of oversupply driving down costs do not apply to captive electric ratepayers. Construction of excess generating capacity paid for through base rates leads to unnecessarily higher costs because the rates include recovery of costs of construction as well as the cost of fuel. In turn, setting rates higher to permit recovery of costs related to excess generating capacity may further depress economic growth and, ironically, reduce the demand for generation capacity.

The N.C. Legislature charged the Commission with the responsibility to ensure the electric rates are fair and reasonable to consumers as well as the shareholders. The Commission must—but has failed to—explain how it reached its conclusion and specifically how it evaluated the changing economic conditions. The importance of the Commission conducting a proper statutory analysis is especially critical in light of modern departures from traditional ratemaking principles. North Carolina, like several other states, has departed from this traditional cost recovery method, in which construction of new power plants was funded through the financial markets (stock and debt). The utility would traditionally apply for a rate increase only after the power plant became operational. The Commission would set rates sufficient to enable investors to
recover their principal investment for prudently incurred costs, and a reasonable rate of return, with the benefit of hindsight to help identify costs that should not be allowed because they are not consistent with sound management. See Hempling. Under that traditional cost recovery and rate setting method, investors bore the full risk of the construction of the power plant, creating a strong investor incentive to ensure costs were prudently incurred so they would later be recovered through rates.

North Carolina now permits regulated utilities to recover costs of construction before a plant becomes operational, shifting far more of the risk onto the ratepayers rather than the investors. Theoretically, advance cost recovery reduces risk of non-recovery and should result in setting lower ROE. See Hempling.

C. Older and low income consumers face dire consequences of a higher than necessary ROE.

In authorizing an unsupported and unreasonably high ROE, the Commission forces older and low income consumers to make choices—between cooling and eating, or lights and medication—that endanger their health and wellbeing. See Lynne Page Snyder & Christopher A. Baker, Affordable Home Energy & Health: Making the Connections, AARP Pub. Pol. Inst. 2, 14 (2010)4 (finding “74 percent of households that include older adults report that they cut back on the purchase of

household necessities because of high home energy bills”). Utility costs typically comprise a large percentage of a consumer’s budget. The average low-income household spends 16 percent of its annual income on home energy costs. Id. “AARP analysis of [Energy Information Administration] data indicates that older consumers with household incomes less than $15,000 have experienced a 32 percent rise in cooling costs since 2005.” Ann McLarty Jackson & Neal Walters, Summer Cooling Costs and Older Households – August 2011, AARP Pub. Pol. Inst. 5 (Aug. 2011).5

To reduce utility costs, lower income older people reduce their heating and cooling to unsafe levels, increasing their risk of death. Between 1999 and 2003, 40 percent of those who died from hyperthermia—exposure to extreme heat—were 65 or older. Ctr. For Disease Control & Prevention, Heat-Related Deaths—United States, 1999-2003, Morbidity and Mortality Weekly Rep., 797 (Jul. 28, 2006).6 In 2010, 71 percent of the 138 heat related deaths occurred among people age 50 or older. See National Oceanic and Atmospheric Administration, 2010 Heat-Related Fatalities, 2 (2011).7


6 Available at http://www.cdc.gov/mmwr/PDF/wk/mm5529.pdf.

The additional money that consumers are forced to pay for higher utility profits is diverting funds they could save for a rainy day, for their retirement, to pay down debt, or to spend to stimulate North Carolina’s economy. These are significant concerns for older people who may not have enough money to sustain them through their retirement years, or for those low income older consumers who rely on Social Security payments averaging $14,000 annually for more than 80 percent of their income. See Gary Koenig & Lina Walker, Fact Sheet, Why Social Security and Medicare are Vital to North Carolina’s Seniors, AARP Pub. Pol. Inst. (2011). 8

CONCLUSION

AARP supports the remedies requested by the Appellant Attorney General, respectfully requesting that the Court remand this matter to the Commission for additional proceedings and a new rate order that is consistent with the requirements of the statute and the arguments herein with regard to Duke’s return on equity.

Respectfully submitted,

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I hereby certify that the foregoing Brief *Amicus Curiae* of AARP in Support of Appellant, North Carolina Attorney General, was electronically submitted to the Supreme Court of North Carolina for filing in the above-captioned case and via email to all parties of record on this 22nd day of August 2012.

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I hereby certify that the foregoing Brief Amicus Curiae of AARP in Support of Appellant, North Carolina Attorney General, was prepared utilizing Times New Roman, 14-point font in Microsoft Word on August 22, 2012 and contains 3420 words.

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