Nos. 271A18 & 401A18

SUPREME COURT OF NORTH CAROLINA

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STATE OF NORTH CAROLINA ex rel. UTILITIES COMMISSION; DUKE ENERGY PROGRESS, LLC, Applicant, Appellees, v. ATTORNEY GENERAL JOSHUA H. STEIN, Intervenor; SIERRA CLUB, Intervenor, Appellants, PUBLIC STAFF—NORTH CAROLINA UTILITIES COMMISSION, Intervenor, Cross-Appellant.	)	From the North Carolina Utilities Commission

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JOINT BRIEF OF INTERVENOR-APPELLANTS NORTH CAROLINA SUSTAINABLE ENERGY ASSOCIATION, NORTH CAROLINA JUSTICE CENTER, NORTH CAROLINA HOUSING COALITION, NATURAL RESOURCES DEFENSE COUNCIL, AND SOUTHERN ALLIANCE FOR CLEAN ENERGY

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ISSUES PRESENTED

I. DID THE COMMISSION ERR BY ORDERING DUKE TO INCREASE THE RESIDENTIAL BASIC FACILITIES CHARGE TO $14.00 AND CONCLUDING THAT SUCH AN INCREASE IS "JUST AND REASONABLE"?

A. Was Commission's Decision to Increase the Basic Facilities Charge to $14.00 Supported by Competent, Material and Substantial Evidence?

B. Was the Commission's Decision to Increase the Basic Facilities Charge an Error of Law Because It Violated the Public Utility Act's Policy of Encouraging the Efficient Use of Electricity and the Requirement that Rates be Fair?

C. Did the Commission's Reliance on a Hypothetical Minimum System to Set the Basic Facilities Charge Violate the Foundational Principle that Utilities Can Only Recover the Actual Costs of Used and Useful Utility Property?

D. Was the Commission's Decision was Arbitrary or Capricious Because It Did Not Address Its Prior Rejection of Using Minimum System to Set the Basic Facilities Charge and Because the Commission Otherwise Ordered a Rate Reduction?

E. Was the Commission's Order Unduly Discriminatory Because It Approved an Increase to the Basic Facilities Charge for Residential Rate Schedules While Leaving the Non-Residential Charges Unchanged?

STATEMENT OF THE CASE

This case began when Duke Energy Carolinas, LLC ("Duke" or "the Company") filed a notice of intent to file a general rate increase application with the North Carolina Utilities Commission (the "Commission") in Docket No. E-7, Sub 1146. (R p 111). Duke filed its Application to Adjust Retail Rates and Charges ("Application") on 25 August 2017. (R p 112) In its Application, the Company requested increased rates, including an increase to the monthly Basic Facilities Charge for the residential and several non-residential customer classes (the "Charge").

The North Carolina Sustainable Energy Association ("NCSEA") filed its Petition to Intervene on 26 July 2017, which the Commission granted on 7 August 2017. (R p 831) NCSEA is a nonprofit organization whose mission is to promote a sustainable future through the use of renewable energy and energy-efficiency programs.

The North Carolina Justice Center ("Justice Center"), North Carolina Housing Coalition ("Housing Coalition"), the Natural Resources Defense Council ("NRDC"), and the Southern Alliance for Clean Energy ("SACE") (collectively, "Justice Center *et al.*") filed a petition to intervene on 19 December 2017. (R p 831) The Justice Center is a nonprofit organization whose mission is to eliminate poverty in North Carolina by ensuring that every household in the state has access to the resources, services, and fair treatment it needs to achieve economic security. The Housing Coalition is a nonprofit membership organization with the goal of ensuring

that every North Carolinian has access to safe, decent, and affordable housing, including advocating for affordable utility rates and charges. Many of the low-income consumers represented by the Justice Center and the Housing Coalition are customers of Duke and will be harmed by an increase to the Charge. (T Vol 26 pp 348-49) NRDC is a national environmental organization that advocates for rate designs that promote efficient, equitable, and affordable electric systems. SACE is a regional nonprofit organization whose mission is to promote responsible energy choices to ensure clean, safe, and healthy communities throughout the Southeast. NRDC and SACE have members who are Duke customers and will be adversely impacted by an increase in the Charge. The Commission granted the Petition to Intervene by Justice Center *et al*. on 11 January 2018. (R p 831)

Duke filed direct testimony along with the Application, and later supplemented its direct testimony. (T Vol 4 pp 304; R pp 830-832) NCSEA and Justice Center *et al.* filed expert testimony in opposition to the Basic Facilities Charge, (R pp 832-833), to which Duke filed rebuttal testimony, (R p 833) The Commission held three public hearings in January 2018, during which numerous members of the public voiced their opposition to Duke's proposal to increase the Charge. (T Vol 1 pp 67-68; Vol 2 pp 19, 42-43)(Doc Ex. 1082) The Commission held an evidentiary hearing beginning on 5 March 2018. (R pp 825-826)

On 22 June 2018, the Commission issued its *Order Accepting Stipulation, Deciding Contested Issues and Requiring Revenue Reduction* (the "Order"), rejecting Duke's proposed revenue increase. (R pp 825-1164) Most pertinent to this appeal,

the Commission granted Duke an increase in the residential Basic Facilities Charge from $11.80 to $14.00. (R p 843) Commissioners ToNola Brown-Bland and Daniel Clodfelter each issued opinions dissenting from portions of the Order, including the majority's decision to increase the Charge. (R pp 1159-1226)

NCSEA and Justice Center *et al.* each filed a Notice of Appeal on 23 July 2018. (R pp 1372, 1377, 1381) The parties entered into a stipulation settling the record on appeal on 7 November 2018. (R p 1407)

STATEMENT OF THE GROUNDS FOR APPELLATE REVIEW

The Commission's 22 June 2018 *Order Accepting Stipulation, Deciding Contested Issues, and Requiring Revenue Reduction* (the "Order") constitutes a final order of the Commission in a general rate case. Appeal to the North Carolina Supreme Court is proper pursuant to N.C. Gen. Stat. §§ 7A-29(b) and 62-90 and N.C. R. App. P. 18.

STATEMENT OF THE FACTS

A. Duke Energy's Request to Increase the Residential Basic Facilities Charge.

The Basic Facilities Charge is a fixed monthly charge that Duke's customers must pay regardless of how much electricity they use. (R p 133) In its Application, Duke sought to increase the Charge for most residential customers by 51%, from

$11.80 to $17.79 per month. (R p 117)[1] The Company's proposal to increase the Charge was part of its request to increase Duke's annual revenues by 12.8%. (R pp 116-17)

1. Effects of a Basic Facilities Charge Increase on Duke's Customers.

Several intervenors presented evidence regarding the harm to low-income households from an increase in the Basic Facilities Charge. John Howat testified on behalf of the Justice Center *et al.* that Duke's proposed increase in the Charge raised profound equity concerns, causing disproportionate harm to low-income, elderly, and African-American ratepayers, who on average use less electricity than other ratepayers. (T Vol 8 pp 23-27) Justice Center *et al.* witness Satana Deberry testified that an increase in the Charge would further burden many low-income residents, pointing out that more than 1.1 million households in North Carolina—31.5% of all of the households in the state—spend 30 percent or more of their income on housing costs, including utility bills. (T Vol 26 p 349)

Consistent with the concerns raised by witnesses Howat and Deberry, the National Association of State Utility Customer Advocates ("NASUCA") has adopted a resolution opposing increases in mandatory, fixed charges like the Basic Facilities Charge. (Doc. Ex. 592-594) The NASUCA resolution states that imposing a "high customer charge …unjustly shifts costs and disproportionately harms low-income, elderly, and minority ratepayers, in addition to low-users of . . . electric utility service in general." (Doc. Ex. 593)

[1] The Company also proposed increases in the Basic Facilities Charge for several of its non-residential rate schedules. (R pp 465-89)

Duke witnesses acknowledged on cross-examination that many of its residential customers already faced difficulty affording essential electric service. (T Vol 7 pp 45-51; Doc. Ex. 767-74) Duke witness Michael Pirro testified that some of Duke's customers could not afford the proposed increase in the Charge, (T Vol 20, pp. 21-22), which causes particularly steep bill increases for those residential customers who use the least amount of electricity. (Doc. Ex. 6157)

A number of parties introduced evidence showing that higher fixed charges discourage the efficient use of electricity. NCSEA witness Justin Barnes testified that a higher fixed charge, which results in a lower variable (or per-kilowatt hour) rate, reduces the incentive for customers to conserve electricity. (T Vol 20 p 71) Public Staff witness Jack Floyd also agreed that a fixed charge sends "a poor price signal." (T Vol 23 p 141) As a result, witness Howat testified, Duke's proposed rate design would discourage energy-efficiency and conservation measures that save customers money on their bills. (T Vol 8 p 23) While true for all customers, "the effect is pronounced for low- to moderate-income customers who face greater pressures on household expenses." *Id*. at 24. If the Charge were increased as Duke requested, Justice Center *et al*. witness Jonathan Wallach calculated that residential electricity use would increase by about 1.7 percent over a several-year period—wiping out about four years' worth of savings from Duke's ratepayer-funded residential energy-efficiency programs. (T Vol 8 p 81)

Testifying for the Public Staff, witness Floyd critiqued the proposed increase in the Charge on two additional grounds. First, he objected to Duke' request

because, if allowed, almost half of the total revenue increase for the standard residential rate class would come through the increase in the Basic Facilities Charge alone. (T Vol 23 p 63) Second, he disagreed with the size of the proposed increase, given its impact on low-usage customers. *Id.* The Public Staff accordingly recommended that any increase in the Charge "should be commensurate with whatever residential revenue change is approved by the Commission." (T Vol 23 p 64) In the event of a revenue decrease, the Public Staff recommended that there be no change to the Charge. *Id.*

2. Duke Used the Disputed Minimum System Method to Support the Basic Facilities Charge Increase.

To support its proposed increase in the residential Basic Facilities Charge, Duke relied on calculations from its cost of service study. The purpose of a cost of service study is to allocate the costs incurred by the utility to the customer classes that caused those costs to be incurred. (T Vol 19, pp 19-20) In the cost of service study, Duke classified costs as either: 1) energy-related (the costs of providing the energy to customers, in kilowatt hours), 2) demand-related (the costs incurred to meet peak demand), or 3) customer-related (the costs to connect each customer to the grid, based on the number of customers served). (T Vol 19, pp 22-23, 35)

Duke used an approach called the "Minimum System" method to classify a portion of the cost of the distribution grid—poles, wires, conductors, and transformers—as "customer-related." (T Vol 19, p 35) The method is based on a hypothetical distribution grid, sized to provide each customer with a very small amount of electricity—for example, enough to power a single light bulb. (T Vol 19 pp

36, 171-72) The additional items that Duke classified as customer-related and included in the Charge—service drop (the line from the grid to the customer's home), meter, billing, and customer service—were not disputed by Intervenors.

Duke then used the results of the hypothetical Minimum System analysis to design its rates, including the Basic Facilities Charge. Duke's use of the Minimum System method resulted in a "theoretical" Charge of $23.78, more than double the existing $11.80 Charge. Citing impacts to low-usage customers and the principle of gradualism, Duke proposed an increase to $17.79. (T Vol 19, pp 60, 84, 148) Duke indicated that it would seek to recover the full amount of the theoretical Charge in future rate cases if the Commission approved its use of the Minimum System method. (T Vol 19 p. 148)

3. Intervenors Challenged Use of the Minimum System to Set the Basic Facilities Charge.

NCSEA and Justice Center *et al*. opposed Duke's use of the Minimum System to set the Basic Facilities Charge. Witness Wallach agreed that rates should be based on principles of cost causation. But he testified that Duke's use of the Minimum System strayed from those principles, inappropriately classifying some distribution grid costs as "customer-related." (T Vol 8 p 79) Because those distribution costs are driven by usage, they should be recovered through the variable, kilowatt hour rate, not through the fixed Charge. (T Vol 8 pp 64, 67)

Witnesses Wallach and Barnes offered testimony regarding the correct method to determine customer-related costs appropriate for recovery through the Basic Facilities Charge. The Charge should be set to recover only the costs directly

attributable to connecting a customer to the grid: the cost of the meter, service drop, and customer services such as meter-reading and billing. (T Vol 8 p 72; Vol 20 p 79) This approach, known as the "Basic Customer method," is used in many states. (T Vol 20 p 79) (R 910)

In response to a discovery request, Duke ran its cost of service study without the Minimum System analysis. After classifying only the costs of the service drop, metering, billing, and customer service as "customer-related," the revised analysis resulted in a theoretical Basic Facilities Charge of $11.08, $0.72 below the then-current Charge. (T Vol 19, p. 178; Doc. Ex. 1094)

B. The Commission's Ruling on the Basic Facilities Charge.

In its final Order, the Commission rejected Duke's proposed rate increase and instead ordered a revenue reduction. (R p. 849) Nevertheless, the Commission ordered an *increase* in the Basic Facilities Charge for the residential rate class to $14.00 per month. (R p. 843) The Commission ordered that the Charge for all other non-residential rate classes should remain unchanged. (R p. 936) The Commission did not find sufficient support to increase the Charge to $17.79, as proposed by Duke. (R p. 936)

The Commission concluded that it "is not persuaded by the evidence presented in this docket that the minimum system analysis employed by the Company is flawed in a way that precludes the Commission from accepting it as appropriate for cost allocation in this proceeding." (R p. 910)

The Commission made no finding that Duke's costs to connect residential customers to the grid have increased, or that its costs to serve residential customers have increased more than the costs to serve non-residential customers. (R p. 1204) Nor did the Commission make any findings with regard to the following: the testimony of witness Howat regarding the correlation between low income and low usage among customers; State policy favoring rates that promote energy conservation, efficiency, and distributed energy resources; its prior rulings that it is not proper to use the results of the Minimum System to set the Charge. (Doc. Ex. 20385-89, R p. 1206).

Commissioners ToNola Brown-Bland and Daniel Clodfelter each issued opinions concurring in part and dissenting in part from the Order. Commissioner Brown-Bland's opinion noted that the $14.00 Basic Facilities Charge adopted by the Commission was the same as that in a settled stipulation between Duke Energy Progress, LLC ("Progress") and the Public Staff in a separate rate case.[2] (R p 1222) No similar settlement was reached in the Duke case. While the majority stated that the $14.00 figure fell within the "range" presented by the parties, Commissioner Brown-Bland observed that the parties did not present a range, but rather two distinct methods of calculating the Charge, and that "[c]hoosing a random number between the two ends offered as evidence without a rational basis does not meet the Commission's obligation to set just and reasonable rates based on substantial evidence." (R p 1223) Commissioner Clodfelter noted the problems with the

[2] *Order Accepting Stipulation, Deciding Contested Issues and Granting Partial Rate Increase*, N.C.U.C. Docket No. E-2, Sub 1142 (23 February 2018) ("Progress Order").

minimum system method discussed by witnesses Barnes and Wallach, and suggested that the time had come to abandon the approach. (R pp 1206-07)

ARGUMENT

I. THE COMMISSION ERRED BY ORDERING DUKE TO INCREASE THE RESIDENTIAL BASIC FACILITIES CHARGE TO $14.00 AND CONCLUDING THAT SUCH AN INCREASE IS "JUST AND REASONABLE."

Before the Commission can increase the monthly Basic Facilities Charge, it must determine that such an increase is just and reasonable, supported by the cost to serve customers, and consistent with the policy declarations in the Public Utilities Act.

Undisputed evidence before the Commission showed that an increase in the Charge disproportionately harms Duke's low-income, senior-citizen, and African-American ratepayers. Contrary to State policy, Duke's regressive rate design also undercuts efforts to conserve energy. Intervenors presented evidence showing that the Charge should remain unchanged, in line with principles of cost causation, fairness, and efficiency.

The only support offered by Duke in support of its request to increase the residential Basic Facilities Charge was the Minimum System method. This method does not reflect Duke's actual costs incurred to meet customers' need for electricity, but is instead based on a hypothetical grid. Duke indicated its intention to seek a Charge reflecting the Minimum System approach—$23.78—in future rate cases.

The Commission erred by increasing the residential Basic Facilities Charge to $14.00 when such an increase:

(A) was not supported by any evidence in the record, let alone competent, material and substantial evidence;

(B) violated State policy, which requires rates that promote the efficient use of electricity and are fair to customers;

(C) contravened the principle that the utility can only recover its actual costs for used and useful property, and not hypothetical costs that were not incurred;

(D) was inconsistent with prior Commission decisions, without explanation, and inconsistent with the overall revenue reduction; and

(E) would be unduly discriminatory to the residential class.

A. The Commission's Decision to Increase the Basic Facilities Charge to $14.00 Was Not Supported By Competent, Material and Substantial Evidence.

The Commission concluded that an increase in the Basic Facilities Charge to $14.00 was just and reasonable, despite the lack of competent, material and substantial evidence in the record to support that amount. This was error.

1. Standard of Review

This Court may reverse or modify the Order if the Commission's "findings, inferences, conclusions or decisions" are, among other things, "[u]nsupported by competent, material and substantial evidence in view of the entire record as submitted." N.C. Gen. Stat. § 62-94(b)(5) (2017). "Substantial evidence" means "more than a scintilla or a permissible inference"—that is, "[i]t means such relevant

evidence as a reasonable mind might accept as adequate to support a conclusion." *State ex rel. Utilities Comm'n v. Carolina Utility Customers Ass'n, Inc.*, 348 N.C. 452, 460, 500 S.E.2d 693, 700 (1998)). Relatedly, "an order 'which indicates that the Commission accorded only minimal consideration to competent evidence constitutes error at law and is correctable on appeal.'" *State ex rel. Utilities Comm'n v. Thornburg,* 314 N.C. 509, 511, 334 S.E.2d 772, 773 (1985) (citing *State ex rel. Utilities Comm'n v. Edmisten*, 299 N.C. 432, 437, 263 S.E.2d 583, 588 (1980)).

2. The Public Utilities Act requires rates and charges to be just and reasonable.

The primary purpose of the Public Utilities Act is "to assure the public of adequate service at a reasonable charge." *State ex rel. Utils. Comm'n v. Gen. Tel. Co.*, 285 N.C. 671, 680, 208 S.E.2d 681, 687 (1974). Consistent with this purpose, the Commission may only approve a rate or charge that the utility has shown to be "just and reasonable." N.C. Gen. Stat. § 62-75; N.C. Gen. Stat. § 62-134(c); *State ex rel. Utilities Comm'n v. Gen. Tel. Co. of Se.*, 281 N.C. 318, 351, 189 S.E.2d 705, 726 (1972).

In making this determination, a regulatory commission must balance both utility and ratepayer interests. *Fed. Power Comm'n. v. Hope Natural Gas Co.*, 320 U.S. 591, 603, 64 S. Ct. 281, 288 (1944). Under the Public Utilities Act, the Commission is directed to "fix such rates as shall be fair both to the public utilities and to the consumer." N.C. Gen. Stat. § 62-133(a). When setting rates, the Commission must consider not only indicia of a utility's economic status, but also "'all other material facts of record' which may have a significant bearing on the

determination of reasonable and just rates." *Edmisten*, 299 N.C. at 437, 263 S.E.2d at 587-88 (quoting N.C.G.S. § 62-133(d).

3. There is no evidence to support the increase to $14.00.

Ultimately, the Commission ruled that there was insufficient support in the record for an increase in the residential Basic Facilities Charge to $17.79 as proposed by Duke. (R p 936) Intervenors agree with this conclusion and no parties challenge it on appeal.

But the Commission did not stop there. It went on to conclude that an increase in the Charge to $14.00 was reasonable, declaring that this amount "lies within the range of the charges advocated by the parties[.]" (R p 937) But the parties did not advocate a "range" of charges. Instead, the parties presented evidence in support of two diametrically opposed outcomes: Duke advocated increasing the charge to $17.79, (R p 936), while all other parties who weighed in on the issue advocated that the Charge should not increase at all in the event of an overall revenue reduction. As Commissioner Brown-Bland put it in her dissent, choosing "a random number between the two ends offered as evidence without a rational basis does not meet the Commission's obligation to set just and reasonable rates based on substantial evidence. See G.S. 62-65 and 62-131." (R p 1223)

In the Order, the Commission stated its findings and conclusions with regard to the Basic Facilities Charge as follows:

> Based upon the entire record in this proceeding, the Commission concludes that DEC shall increase the monthly BFC for the residential rate class (Schedules RS, RT, RE, ES, and ESA) to $14.00. The Commission finds and concludes that the increase in the BFC for the residential rate class schedules is just and reasonable and strikes the

> appropriate balance providing rates that more clearly reflect actual cost causation.

(R p 936) But nothing in the entire record supports its conclusion that $14.00 is just and reasonable. No party provided evidence that would support a $14.00 residential Charge. That number was not supported by *any* evidence, let alone competent, material and substantial evidence.

The Commission went on to explain:

> The increase in these schedules minimizes subsidization and provides more appropriate price signals to customers in the rate class, while also moderating the impact of such increase on low-income customers to the extent that they are high-usage customers such as those residing in poorly insulated manufactured homes.

(R p 936) As set forth in Section C, below, the Commission's references to "subsidization" and "price signals" are entirely dependent on its erroneous acceptance of Duke's Minimum System methodology. And the concern about high-usage customers residing in manufactured homes, while undoubtedly sincere, is completely fabricated. The record lacks any evidence to support a finding that low-income customers who reside in manufactured homes are high-usage customers. Quite the opposite, the Commission was presented with detailed and unrebutted evidence showing that low-income households tend to be low-usage customers. (T Vol 8 pp 23-28)

In explaining its decision to allow an increase in the Charge, the Commission continued:

> In arriving at this decision, the Commission gives substantial weight to the testimony of Company witness Pirro concerning cost of service. The Commission agrees with witness Pirro's testimony that failing to

> properly recover customer-related cost via a fixed monthly charge provides an inappropriate price signal to customers and fails to adequately reflect cost causation.

(R p 936) But witness Pirro's testimony did not support the Commission's decision to increase the Charge to $14.00. Witness Pirro instead provided the following reasons for the Company's proposed increase:

> [Duke] requests to increase the monthly BFC from $11.80 to $17.79 to better recover customer-related cost identified in the unit cost study for the residential rate class. Although the Company's analysis supports increasing the BFC to $23.78, we have suggested a smaller increase to moderate any effect on low usage customers.

(T Vol 19 p 60) Witness Pirro never suggested that Duke's analysis would support a $14.00 Charge. While the Commission may simply be relying upon witness Pirro's testimony as evidence than *some* increase is necessary, there is nothing in the record substantiating the increase to $14.00.

Evidence presented by a number of witnesses supported either no change to the Charge, or a lesser increase. Public Staff witness Floyd proposed an increase equivalent to no more than 25% of the approved revenue increase assigned to that customer class, or no change in the event of an overall revenue decrease. (R p 933; T Vol 23 p 64) NCSEA witness Barnes recommended that the residential Charge be maintained at its then-current level, or, alternatively, that it be increased only by the percentage increase in the overall revenue requirements adopted for the class. (R p 933; T Vol 20 p 61) Justice Center *et al.* witness Wallach recommended that the Charge be maintained at $11.80. (T Vol 8 p 76) All of these witnesses provided support for not raising the Charge in the event of a revenue reduction.

Commissioner Clodfelter recognized the lack of support for an increase in the Charge in his separate dissent on the issue, stating that he would not authorize any increase in the BFC "on the grounds that there is no evidence on the record to support any such increase." (R p 1159) Commissioner Clodfelter went on to explain that

> The majority does not support its determination with any findings or evidence showing that the Company's fixed costs to serve residential customers has increased over what is supported by the revenues upon which the Company's present rates are based. It does not make findings or point to any evidence that the fixed costs to serve residential customers have increased relative to costs of service for non-residential customers.

(R p 1204)

Commissioner Brown-Bland, likewise dissenting, stated:

> I join in Commissioner Clodfelter's dissenting opinion to the extent he finds that the majority decision to increase the residential fixed charge from $11.80 to $14 is not supported by any evidence of record, let alone substantial evidence as is required for all Commission decisions pursuant to G.S. 62-65, and to the extent of the shortcomings and criticisms he finds regarding the majority's "subsidization" and "cost causation" rationales for increasing the fixed residential charge by $2.20 per month.

(R p 1222)

Commissioner Brown-Bland identified the most likely source of the $14.00 figure in her dissent: "while the increase to $14.00 appears to be arbitrary, it just happens to be the same as the fixed residential customer charge adopted in the Commission's Order" in the Progress rate case. *Id.* In other words, the $14.00 figure the Commission picked appears to be the

product of a stipulation of settlement in a different case, with a different evidentiary record, and in the context of a revenue increase.

This Court must determine whether the Commission gave adequate consideration to all evidence in setting the new Basic Facilities Charge. The Commission cannot "merely recite[ ] the witnesses' testimony," but must "explain[ ] the weight given to each witness's testimony." *State ex rel. Utilities Comm'n v. Cooper*, 367 N.C. 644, 649, 766 S.E.2d 827, 830 (2014). In the Commission's Order, there was no such weighing of each witness's testimony as to the reasonable amount of the Charge. The evidence, findings and conclusions that are required are akin to a "chain of reasoning" that must be apparent in the Commission's Order: "'Evidence must support findings; findings must support conclusions; conclusions must support the judgment. Each step of the progression must be taken . . . in logical sequence; each link in the chain of reasoning must appear in the order itself.'" *State ex rel. Utils. Comm'n v. Eddleman*, 320 N.C. 344, 352, 358 S.E.2d 339, 346 (1987) (quoting *Coble v. Coble*, 300 N.C. 708, 714, 268 S.E.2d 185, 190 (1980)). There is no such chain linking evidence in the record to the Commission's decision to set the Charge at $14.00.

Instead of forging a logical chain of reasoning, the Commission merely recited a summary of the testimony. (R pp 933-36) It did not consider that testimony in landing on the $14.00 figure. This analysis does not meet the standards in Chapter 62 for setting new rates. "[A]n order 'which indicates that the Commission accorded only minimal consideration to competent evidence constitutes error at law and is

correctable on appeal.'" *Thornburg*, 314 N.C. at 511, 334 S.E.2d at 773 (citing *Edmisten,* 299 N.C. at 437, 263 S.E.2d at 588)).

No "competent, material and substantial evidence" exists in this record to support a conclusion that an increase in Charge to $14.00 would be fair to customers. *Cooper*, 366 N.C. at 490, 739 S.E.2d at 545; N.C. Gen. Stat. § 62-94(b). As a result, the Commission erred in determining there should be an increase in the BFC to $14.00.

B. The Commission's Decision to Increase the Basic Facilities Charge Was an Error of Law Because It Violated the Public Utility Act's Policy of Encouraging the Efficient Use Of Electricity and the Requirement that Rates be Fair.

1. Standard of Review

This Court may reverse or modify the Order if the Commission's "findings, inferences, conclusions or decisions" are affected by an error of law. N.C.G. S. § 62-94(b)(4). The Commission's failure to consider whether the increased Charge would contravene State policy is an error of law, which is reviewed *de novo*. N.C. Gen. Stat. § 62–94(b) ("the court shall decide all relevant questions of law [and] interpret constitutional and statutory provisions"). Under *de novo* review, the court considers the matter anew and freely substitutes its own judgment for that of the Commission. *See In re Appeal of Greens of Pine Glen Ltd.*, 356 N.C. 642, 647, 576 S.E.2d 316, 319 (2003).

2. The increased Charge for residential customers will hinder energy conservation, contrary to the policy dictates in the Public Utilities Act.

The Commission contravened state law and policy by ordering an increase in the residential Basic Facilities Charge. This Court has previously ruled that the Commission is required to "accomplish 'the legislature's purpose and comport[ ] with its public policy" when applying a statute. *State ex rel. Utilities Comm'n v. Simpson*, 295 N.C. 519, 524, 246 S.E.2d 753, 757 (1978) (quoting *State ex rel. Utilities Comm'n v. Simpson*, 32 N.C. App. 543, 546, 232 S.E.2d 871, 873 (1977)). The rate-making provisions governing the Commission's decision are part of the Public Utilities Act, which declares that it is the policy of the State "to require . . . fixing of rates in a manner to result in the least cost mix of generation and demand-reduction measures which is achievable," "[t]o provide just and reasonable rates . . . consistent with . . . conservation of energy resources by avoiding wasteful, uneconomic and inefficient uses of energy," and "[t]o encourage and promote harmony between the public utilities, their users and the environment." N.C. Gen. Stat. § 62-2(a)(3a), (4), (5) (2017). N.C. Gen. Stat. § 62-155(a), titled "Electric power rates to promote conservation," similarly states that "[i]t is the policy of the State to conserve energy through efficient utilization of all resources." The Commission failed to consider this important public policy when setting the residential Charge.

The Commission heard extensive testimony that the Company's proposed rate design would frustrate the policy goals of the Public Utilities Act. As witness Barnes testified, when the fixed charge is increased, the correspondingly reduced variable rate "provide[s] less of an incentive for customers to reduce their demand

or overall energy use." (T Vol 20 p 71) Likewise, witness Howat stated that high fixed charges "send the wrong price signals to customers, discouraging energy efficiency and undermining the incentive to change usage patterns so that increased investment in high-cost generation can be avoided." (T Vol 8 pp 22-23)

An increased fixed charge leads to uneconomic and inefficient usage by customers, which "can lead to additional investments by the utility," putting additional upward pressure on rates in the future. (Doc. Ex. 1100) Witness Howat testified that the proposed increase to the Charge was "counter to the policy of the State of North Carolina" and "reduces [customer] savings achieved from energy-efficiency measures" which causes it to work "against" North Carolina energy policy. (T Vol 8 p 24) Witness Wallach concluded that Duke's proposed increase in the Charge, and the resulting lower variable rate, would "undo about four years of…energy savings from the residential energy efficiency portfolio." (T Vol 8 p 75)

The Commission did not consider the inconsistency between an increase in the Basic Facilities Charge and the Public Utilities Act's mandate that rates promote conservation, demand reduction, and efficiency. Without weighing the relevant evidence or considering these policy directives, the Commission determined that failing to increase the residential Charge would send "inappropriate" price signals to customers. (R p 936) The rate design approved by the Commission fails to meet the requirements of N.C. Gen. Stat. §§ 62-2(a) and 62-155(a) because it penalizes customers who have taken steps to conserve energy and fails to promote energy efficiency by decreasing customer incentives to behave efficiently. In its

Order, the Commission failed to uphold, or even acknowledge, its duty to further these statutory goals.

The Commission cannot ignore policy goals established by the General Assembly. The mandate to set "just and reasonable" rates must be read in harmony with the whole Public Utilities Act and the purposes set forth at the outset of the act. N.C. Gen. Stat. § 62-130; *Vogel v. Reed Supply Co.*, 277 N.C. 119, 131, 177 S.E.2d 273, 280 (1970) (the terms of a statute must be construed in harmony with the whole and given only that meaning that other provisions and the purposes of the act permit). The Commission erred by disregarding the policy directives of the Public Utilities Act when it ordered an increase in the fixed Charge. *Simpson*, 295 N.C. at 524, 246 S.E.2d at 757.

3. The increased Basic Facilities Charge unfairly impacts low-income and minority ratepayers.

Additionally, the Commission's decision contravened state law and policy because the increased residential Charge unfairly impacts low-income and minority households, which tend to use less electricity than the average household. This Court has recognized that "fairness to customers is a critical consideration in rate cases" and that "customer interests cannot be measured only indirectly or treated as mere afterthoughts." *Cooper*, 366 N.C. at 495, 739 S.E.2d at 548; N.C. Gen. Stat. § 62-133(a) (rates must be fixed so as to be fair to both the utility and the public).

The Commission heard testimony from multiple witnesses that the proposed increase in the Basic Facilities Charge would disproportionately impact low-usage customers, (T Vol 23 p 63; R pp 932-37; Doc. Ex. 6157-61), who, in turn, are

disproportionately low-income, elderly, and African-American, (T Vol 8 pp 23-27) Witnesses Howat and Deberry provided detailed testimony about the difficulty low-income households would have affording the Company's proposed increase to the Charge. (T Vol 8 pp 31-33; T Vol 26 pp 349-51) Increasing the Charge decreases those customers' ability to control their own electricity bills.

Duke did not present any "competent, material and substantial evidence" to support a conclusion that its proposed rate design would be fair to its low-income, African-American, or senior-citizen customers. N.C. Gen. Stat. § 62-94(b). Duke's own data showed that a significant number of residential customers struggled to afford electricity service even under the then-current rates and fixed Charge. (Doc. Ex. 767-74) When cross-examined about concerns that customers could not afford the increased Charge, Duke witness David Fountain pointed to the Company's sole low-income energy-efficiency program as a way to help those customers manage their electric bill. But he admitted that the average bill savings from that program would be wiped out by Duke's proposed increase to the Charge. (T Vol 7 p. 54)

Oddly, the Commission found that increasing the Charge would "moderat[e] the impact of such increase on low-income customers to the extent that they are high-usage customers such as those residing in poorly insulated manufactured homes." (R p 936) As noted by Commissioner Clodfelter in his dissent, the "difficulty with this picture is that it is conclusory and simply without evidentiary support in the record." (R p 1205) Indeed, this notion was refuted by the testimony of witness Howat that low-income customers tend to have lower-than-average

electricity usage. (T Vol 8 pp 25-29) No party provided evidence about the number or energy-usage patterns of low-income customers who live in poorly insulated manufactured homes.

Evidence in the record should have prompted the Commission to consider whether a higher Charge would be unfair to low-income, senior, and minority households, contrary to the requirement to consider fairness to customers in setting rates. N.C. Gen. Stat. § 62-133(a). The Commission erred by treating the negative impact to those customers as a mere afterthought. *Cooper*, 366 N.C. at 495, 739 S.E.2d at 548.

The Commission's decision to enact a Basic Facilities Charge that is unfair and will lead to the inefficient use of electricity in violation of the policy of North Carolina is an error of law. Accordingly, this Court should reverse the Commission's decision to raise the Charge and modify the Order in order to maintain the current Charge, which more accurately reflects the policy of the State.

C. The Commission's Reliance on a Hypothetical Minimum System to Set the Basic Facilities Charge Violated the Foundational Principle that Utilities Can Only Recover the Actual Costs of Used and Useful Utility Property.

Rates fixed by the Commission must be based on the actual costs of "used and useful" property—that is, power plants, transmission lines, distribution grid equipment, or other infrastructure that the utility uses to provide electricity to its customers. N.C. Gen. Stat. § 62-133(b)(1). Duke's justification for an increased Basic Facilities Charge, however, was based instead on a hypothetical distribution

grid that will never be "used and useful," because it exists only in the minds of Duke's engineers.

Because the Company did not actually incur the hypothetical Minimum System costs to serve its customers, treating those hypothetical costs as "customer-related" and using them to set the Basic Facilities Charge violated foundational principles of ratemaking embodied in North Carolina law.

1. Standard of Review

Only the cost of "used and useful" utility property may be recovered through rates. It was thus an error of law for the Commission to set the Basic Facilities Charge based on Duke's cost estimate for a hypothetical "minimum" grid that does not exist. N.C. Gen. Stat. §§ 62-94(b) and 62-133(b)(1). Errors of law are reviewed *de novo*. N.C. Gen. Stat. § 62–94(b) ("the court shall decide all relevant questions of law [and] interpret constitutional and statutory provisions"). "Under *de novo* review this Court considers the matter anew and freely substitutes its judgment for that of the Commission. *Pine Glen Ltd.*, 356 N.C. at 647, 576 S.E.2d at 319.

2. The Company Did Not Build a "Minimum System" and Thus Incurred No Costs to Build One.

The mandate to fix rates based on the actual, original costs to serve customers is well-established. When fixing rates, the Commission must "[a]scertain the reasonable original cost…of the public utility's property used and useful…in providing the service rendered to the public." N.C. Gen. Stat. § 62-133(b)(1). "The test for whether the cost of facilities of a public utility may be included in the rate base is whether such facilities are used and useful." *State ex rel.*

Utilities Comm'n v. N. C. Textile Mfrs. Ass'n, Inc., 313 N.C. 215, 229–30, 328 S.E.2d 264, 273 (1985) (citing *Utilities Comm'n. v. Power Co.,* 285 N.C. 377, 387, 206 S.E.2d 269, 276 (1974)).

The Commission's Order allowing the use of the Minimum System method as justification for the increase in the Basic Facilities Charge was purportedly based on "cost causation," as argued by Duke. (R p 937) (T Vol 19 pp 20-22, 34-36, 43, 83-85, 181) But the cost-causation argument for increasing the Charge was based entirely on the results of its Minimum System method.

The Minimum System method turns foundational ratemaking principles upside down. Under this approach, Duke theorized that each residential customer "caused" the utility to incur a portion of the cost of a hypothetical distribution grid to serve a near-zero load (the "minimum system"). But Duke did not build a "minimum system." Instead, Duke built and sized the distribution grid to serve actual customer load. (T Vol 20 p 78)

Basing rate design on something other than the actual costs the utility incurred to serve customer demand is fraught with the potential for error and confusion. Duke's Minimum System cost estimates highlight these dangers. Witness Barnes noted that there were instances in the Company's Minimum System analysis where "the customer-related percentage of the distribution system is effectively driven by…*non-existent facilities*." (T Vol 20 p 88) (emphasis added).[3]

[3] For example, when the Company tried to account for the presence of underground wires in its analysis, it hypothesized overhead wires in their place. (T Vol 20 pp 87-88) But there was "no way to determine whether this fictional overhead system

Witness Wallach also identified ways in which the hypothetical Minimum System serves as a poor proxy for the actual, used and useful distribution grid. The "analyses overstate the minimum plant cost per customer because they assume that a minimum system…would have the same number of poles, conductor feet, and transformers" as installed in the real-world grid. (T Vol 8 p 67) This assumption is not realistic, because the equipment imagined under the Company's Minimum System method would be capable of serving more than the minimal demand of customers. *Id.* Witness Barnes also found that, because of Duke's flawed assumptions, it overstated the size of overhead line transformers in its analysis. (T Vol 20 p 91)

In short, Duke's reliance on the Minimum System method resulted in hypothetical grid cost estimates that do not comport with the Company's actual, original costs of used and useful property. [4] (T Vol 20 p 88) By accepting these estimates, the Commission violated its obligation to base rates on an ascertainment of the original costs of utility property that is used and useful in providing service to the public. N.C. Gen. Stat. § 62-133(b)(1). The Commission's conclusion that the Minimum System results are appropriate for establishing the Basic Facilities Charge thus constitutes an error of law and should be reversed.

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accurately represents how the system would look if all electric distribution was accomplished using overhead facilities." (T Vol 20 p 88)

[4] Intervenors are not, in this instance, asserting that the Commission erred in not giving more weight to the testimony of witnesses Barnes and Wallach regarding flaws in the Company's application of the Minimum System method. Instead, their testimony shows the wide gulf that exists between the original costs of the used and useful distribution grid and the hypothetical, minimal grid that was the basis for increasing the Basic Facilities Charge.

D. The Commission's Decision Was Arbitrary or Capricious Because It Did Not Address Its Prior Rejection of Using Minimum System to Set the Basic Facilities Charge and Because the Commission Otherwise Ordered a Rate Reduction

The Commission has previously rejected the use of the Minimum System method as a basis for setting the Basic Facilities Charge. In this case, however, the Commission sanctioned the use of the Minimum System to increase the Charge, without acknowledging or explaining its prior, contrary decisions. (R p 936) The Commission's decision to increase the Charge when it ordered an overall rate decrease was arbitrary and capricious.

1. Standard of Review

The Commission has an obligation to render reasoned decisions that are not arbitrary or capricious. N.C. Gen. Stat. § 62-94(b)(6). Decisions are arbitrary and capricious "when, among other things, they indicate a lack of fair and careful consideration or fail to display a reasoned judgment." *Thornburg*, 314 N.C. at 515, 334 S.E.2d at 776.

2. Dissimilar treatment of the same issue is arbitrary or capricious.

The General Assembly's use of the "arbitrary or capricious" standard in the Public Utilities Act indicates its intent to incorporate the existing federal interpretation of that standard. *State v. McGrady*, 368 N.C. 880, 887, 787 S.E.2d 1, 7 (2016) ("[W]hen the General Assembly adopts language or statutes from another jurisdiction, 'constructions placed on such language or statutes are presumed to be adopted as well.'").

Under the federal Administrative Procedures Act, first enacted in 1946, federal agencies are required to provide a reasoned decision for their actions. 5 U.S.C. § 706(2)(A); *F.C.C. v. Fox*, 556 U.S. 502, 515, 129 S. Ct. 1800, 1811 (2009). This includes a requirement that an agency acknowledge when it is changing position. "An agency may not . . . depart from a prior policy *sub silentio*. . . . [a]nd of course the agency must show that there are good reasons for the new policy." *Id.* Unexplained, inconsistent decisions by federal agencies are quintessentially arbitrary. *Colorado Interstate Gas Co. v. F.E.R.C.*, 850 F.2d 769, 774 (D.C. Cir. 1988) (holding that the FERC's "dissimilar treatment of evidently identical cases…seems the quintessence of arbitrariness and caprice"). An agency that changes direction on an identical issue over time must "offer a rational explanation of the shift." *Id.* (citing *Motor Vehicle Mfrs. Ass'n v. State Farm Mutual Automobile Ins. Co.,* 463 U.S. 29, 41-42, 103 S. Ct. 2856, 2866 (1983); *Greater Boston Television Corp. v. FCC,* 444 F.2d 841, 852 (D.C.Cir. 1971)).

3. The Commission's abrupt departure from prior decisions rejecting the use of Minimum System for rate design, without explanation, was arbitrary and capricious.

The Commission's departure from its prior decisions without offering a reasoned explanation, or even an acknowledgement of those decisions, evinced a lack of careful consideration and demonstrated that the Commission failed to use reasoned judgment. The Commission's Order was thus arbitrary and capricious.

The only basis for the Commission's decision to increase the Basic Facilities Charge came from "the testimony of Company witness Pirro concerning cost of service," which, in turn, was based on the results of the Minimum System method.

(R p 936) In its Order, the Commission did not explain why it changed direction in this case and did not address its prior, contrary rulings. As a result, its decision was arbitrary and capricious.

In its only decisions on this subject for electric public utilities in recent decades, the Commission has rejected the importation of the Minimum System method from the cost of service study to the rate design process, and specifically, the process of setting the fixed customer charge. *See, e.g.*, *Order Granting Partial Increase In Rates and Charges*, N.C.U.C. Docket No. E-2, Sub 526, 87 P.U.R.4th 64, 90 (27 August 1987); *Order Granting Partial Increase In Rates and Charges*, N.C.U.C. Docket No. E-2, Sub 537, 94 P.U.R.4th 353, 466 (5 August 1988) ("such reflection of minimum distribution plant costs in the basic customer charges would result in residential customer charges at least double the current $6.75 per month. The Commission has never approved residential customer charges approaching the levels indicated by the minimum system technique."). Prior to its Order here, the Commission had not deviated from this established position.

Duke's testimony obscured the difference between using Minimum System for cost-allocation—which has been endorsed by the Commission—and using it for setting the Basic Facilities Charge, which has been rejected. Company witness Hager testified that "the minimum system study has long been used in the cost of service study to develop the customer-related costs that are then passed to rate design and are the basis of rates that are ultimately approved by this Commission." (T Vol 19 p 138-39) The Commission gave weight to that testimony and cited it as a

primary reason for its decision to accept the use of Minimum System in Duke's cost of service study. (R p 911) (stating that the Commission "places significant weight on the testimony of Company witness Hager regarding the Company's long history of employing the minimum system method….").

But witness Hager's implication that the Commission had previously blessed the use of the Minimum System for setting the Basic Facilities Charge was incorrect. The Commission has not issued a ruling endorsing use of the Minimum System method to justify an increase in the Charge in any Duke rate case in recent decades. Instead, the Commission has accepted stipulations of settlement on the Charge each case since 2007. (T Vol 19 pp 159-64) (Doc. Ex. 20387-88)

Thus, over the course of four rate cases, the Commission approved stipulations allowing a cumulative increase in Duke's residential Basic Facilities Charge of 33.3 percent—less than the increase that Duke sought in this single rate case. In none of those cases did the Commission overrule or reconsider—or even have occasion to consider or reconcile—its prior orders prohibiting the use of the Minimum System method to set the Charge.

Because the Commission reversed course without acknowledgment or explanation, its decision is not the product of reasoned judgment or careful consideration. *State ex rel. Utilities Comm'n v. Thornburg*, 314 N.C. at 515, 334 S.E.2d at 776. As such, its unexplained about-face should be reversed as arbitrary and capricious.

4. It was arbitrary or capricious for the Commission to Order an Increase in the Residential Basic Facilities Charge After Ordering a Revenue Reduction for Duke.

Duke proposed increases to the Basic Facilities Charge as part of a request for a large rate increase. Duke sought an overall increase in residential rates of 16.7 percent, along with an increase in the residential Charge of roughly 51 percent (R p 352). During the pendency of the case, Duke's requested increase in the revenue requirement ballooned to over $700,645,000. (R p 836) The Commission rejected the requested increase, and instead imposed a decrease, reducing the total net revenue requirement by $72,862,000. (R p 1394) Despite otherwise ordering a decrease in rates, the Commission ordered an *increase* in the residential Charge by 18.64 percent. This decision was arbitrary and capricious

No party presented evidence to support an increase in the residential Basic Facilities Charge in the event of a revenue reduction—a foreseeable outcome, given the federal corporate income tax rate reductions. Public Staff witness Floyd anticipated this possibility, and recommended that the Charge remain unchanged in the event of a revenue decrease. (T Vol 23 p 64) NCSEA witness Barnes recommended that the current residential Charges be maintained, or, alternatively, that any increase be capped at the percentage increase in the overall revenue requirement approved for the class. (T Vol 20 p 61) Duke presented no evidence regarding the appropriate residential Charge in the event of an overall rate decrease. In this case, there was not even a scintilla of evidence to support an increase in the Charge in light of an overall revenue decrease. *State ex rel. Utilities Comm'n v. Cooper*, 367 N.C. 430, 438, 758 S.E.2d 635, 640 (2014).

In their dissenting opinions, both Commissioners Brown-Bland and Clodfelter disapproved of the majority's illogical decision to increase the Charge in the context of an overall rate decrease. (R p 1204, 1223) As Commissioner Brown-Bland explained, "[Duke's] overall revenue requirement is being decreased in the present general rate case, suggesting that any alleged subsidy effect cited by the majority is already minimized to a degree by the lesser revenue requirement, alleviating the perceived need to increase the residential fixed charge in haste." (R p 1223) Commissioner Clodfelter noted that "if there is no demonstrated need for additional revenue to be provided from residential ratepayers, other justifications for the increase must be found." (R p 1205) No such justification can be found in the record.

The decision to increase the Charge while reducing rates overall is also at odds with the Commission's prior decisions, in which it has generally approved adjustments to the Basic Facilities Charge that were commensurate with the overall change in rates. For example, in approving a 2012 rate increase, the Commission approved a rate design in which "each rate component for each rate schedule, including the Basic Facility Charges, shall be modified by an equal percentage to arrive at a 7.21% increase." *Order Granting General Rate Increase*, N.C.U.C. Docket No. E-7, Sub 989, at 43, 2012 WL 345039 (27 January 2012). In these prior cases, as summarized above, the Commission and stipulating parties recognized the common-sense principle that an adjustment to the Basic Facilities Charge should bear some logical relationship to the overall change in rates.

In this case, the Commission's failure to address and justify the stark inconsistency in its decision to increase the residential Charge while mandating an overall rate decrease "evinces a lack of fair and careful consideration or want of impartial, reasoned decisionmaking." *Joyce v. Winston–Salem State Univ.*, 91 N.C. App. 153, 156, 370 S.E.2d 866, 868, *cert. denied*, 323 N.C. 476, 373 S.E.2d 862 (1988). Therefore, its decision was arbitrary and capricious and should be reversed. N.C. Gen. Stat. § 62-94(b)(6).

E. The Commission's Order Was Unduly Discriminatory Because It Approved an Increase to the Basic Facilities Charge for Residential Rate Schedules While Leaving the Non-Residential Charges Unchanged.

1. Standard of review

"[T]he question of unreasonable discrimination among and within the classes of service is a material issue of fact and law"; as a result, the "Commission's failure to [adequately] address this issue in its findings of fact is error prejudicing the substantial rights of defendants." *N.C. Textile Mfrs. Ass'n*, 313 N.C. at 223, 328 S.E.2d at 269-70 (remanding to Commission to consider issue and make appropriate findings). This error is grounds for this Court to modify or reverse the Commission's decision under N.C. Gen. Stat. § 62-94(b)(4).

To survive appellate review, the Commission's findings of fact must also be supported by "competent, material and substantial evidence in view of the entire record." N.C. Gen. Stat. § 62-94(b)(5).

2. It was unduly discriminatory to increase the Basic Facilities Charge for the residential class while leaving the Charges unchanged for other rate classes.

Duke asked the Commission to approve an increase in the monthly Basic Facilities Charge for ratepayers on the standard residential rate from $11.80 to $17.79 per month. (R p 365) At the same time, Duke proposed increases in the Charge for several non-residential rate classes[5], and decreases in the Charge for other non-residential classes. (R p 365) Yet the Commission, while granting an increase in the standard residential Charge to $14.00 per month, left the Charges for the non-residential classes unchanged, finding and concluding that this outcome was "just and reasonable . . . based upon the evidence in the record." (R p 936) This differential treatment amounted to unjust discrimination toward the residential class, in violation of North Carolina law. It was also arbitrary and capricious and not supported by competent, material and substantial evidence.

The Commission explained its finding and conclusion as follows:

> In support of these conclusions, the Commission notes that other non-residential rate schedules are more complex, thus allowing for the minimization of cost-subsidization issues and ensuring greater consistency with cost causation and allocation principles. In addition, the Commission notes that a greater amount of fixed costs in the residential rate schedule, as opposed to non-residential rate schedules, presently are recovered through variable energy rates, which is inconsistent with basic cost allocation principles that fixed costs should be recovered through fixed charges, whereas variable costs should be recovered through variable charges.

(R pp 936-937)

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[5] The Company proposed increases in the Basic Facilities Charge for several of its non-residential tariffs: Small General Service, Building Construction Service, Large General Service, Traffic Signal Service, Industrial Service, OPT-E, and Parallel General. (R pp. 465-89)

With regard to the first part of the Commission's rationale, the vague reference to "minimization of cost-subsidization issues" presumably refers to higher-usage customers allegedly subsidizing costs incurred by lower-usage customers. But as Commissioner Brown-Bland pointed out in dissent, "while the majority states a concern about minimizing subsidization, its focus is unfairly and discriminatorily upon only the residential class of customers." (R p 1223)

North Carolina law prohibits unjust discrimination in ratemaking. N.C. Gen. Stat. § 62-2(a)(4) (declaring the public policy of our State is "to provide just and reasonable rates and charges for public utility services without unjust discrimination, undue preferences or advantages . . . ."). Likewise, the law prohibits unreasonable differences in rates between customer classes: "No public utility shall establish or maintain any unreasonable difference as to rates . . . as between classes of service." N.C. Gen. Stat. § 62-140(a). In applying this provision, this Court has held that "[a] substantial difference in service or conditions must exist to justify a difference in rates." *N.C. Textile Mfrs. Ass'n,* 313 N.C. at 222, 328 S.E.2d at 269. *Accord Carolina Util. Customers Ass'n, Inc.*, 348 N.C. 452 at 468, 500 S.E.2d at 704 (1998) ("classifications of customers and differences in rates must be based on reasonable differences in conditions, and the variance in charges must bear a reasonable proportion to the variance in conditions").

The Commission did not point to any competent, material and substantial evidence of a difference in conditions between customer classes to support its determination to increase the residential Charge while leaving the non-residential

Charges the same. Instead, the Commission offered only murky generalizations and a vague reference to evidence in the record. As pointed out by Commissioner Clodfelter in his dissenting opinion:

> [T]o support such a difference in treatment between the residential and nonresidential classes, there must be justifications peculiar to the residential rate classes and not applicable to the non-residential rate classes….the majority's justifications, to the extent they are articulated at all, are without basis in the record.

(R p 1205) The lack of a clearly articulated justification based on record evidence renders the Commission's determination unjustly discriminatory, as well as arbitrary and capricious.

The second part of the Commission's rationale consisted in a concern that a greater portion of fixed costs are recovered through variable rates in the residential class than in the non-residential classes. Whether this is actually a problem to be remedied hinges on Duke's use of the disputed Minimum System method to identify certain distribution costs as "fixed." Thus, to the extent any of the Commission's findings were supported by any evidence in the record, they were premised on acceptance of the disputed Minimum System method, which itself was error for the reasons discussed in detail in Section C, above.

In this case, the Commission made no specific findings that a difference in the cost to serve residential versus non-residential ratepayers justified an increase in the Charge for residential rate class, with no increase in the Charges for non-residential rate classes. "[The majority] does not make findings or point to any evidence that the fixed costs to serve residential customers have increased relative

to costs of service for non-residential customers." (R p 1204) This omission was error, and requires a remand.

CONCLUSION

Justice Center *et al*. and NCSEA respectfully request that this Court reverse and modify the Commission's Order increasing the residential Basic Facilities Charge to return the Charge to $11.80, or, in the alternative, reverse and remand the Order for further proceedings. N.C. Gen. Stat. § 62-94(b).

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This the 26th day of April, 2019.

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