

SUPREME COURT OF NORTH CAROLINA

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STATE OF NORTH CAROLINA EX )  
REL. UTILITIES COMMISSION; )  
AQUA NORTH CAROLINA, INC., )  
Applicant; PUBLIC STAFF- )  
NORTH CAROLINA UTILITIES )  
COMMISISON, Intervenor, )

Appellees, )

v. )

ATTORNEY GENERAL ROY COOPER, )  
Intervenor, )

Appellant. )

From the North Carolina  
Utilities Commission

Docket No. W-218, SUB 363

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BRIEF OF INTERVENOR-APPELLANT  
ATTORNEY GENERAL ROY COOPER

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ISSUE PRESENTED

I. WAS THE COMMISSION’S ORDER FINDING THAT THE IMPROVEMENT CHARGE MECHANISM IS IN THE PUBLIC INTEREST SUPPORTED BY COMPETENT, MATERIAL, AND SUBSTANTIAL EVIDENCE, AND WAS IT BASED ON SUFFICIENT FINDINGS, CONCLUSIONS AND REASONING WHICH CONSIDERED THE RELEVANT, MATERIAL FACTORS BEARING ON THE PUBLIC INTEREST?

## **STATEMENT OF CASE**

On 2 May 2014, the North Carolina Utilities Commission (the “Commission”) issued an Order Granting Partial Rate Increase, Approving Rate Adjustment Mechanism, And Requiring Customer Notice (the “Order”) to Aqua North Carolina, Inc. (“Aqua”). In its Order, the Commission, in addition to granting a 5.2% (\$2,457,041) general rate increase, approved an improvement charge, rate adjustment mechanism (“the improvement charge mechanism”) for recovery of water and sewer system improvements charges for infrastructure projects, per newly-enacted N.C. Gen. Stat. § 62-133.12. (R3 p 433), finding that adoption of this mechanism was in the public interest. This public interest determination is the subject of the appeal at hand. On 2 July 2014, the North Carolina Attorney General (the “Attorney General”) filed a Notice of Appeal and Exceptions. (R4 p 582).

The underlying case began on 2 July 2013, when Aqua filed a letter of intent notifying the Commission of its intent to file a general rate case application. (R1 p 3) On 2 August 2013, Aqua filed its application, petitioning for authority to implement the improvement charge mechanism. (R1 p 6) The Attorney General and the Public Staff – North Carolina Utilities Commission (“Public Staff”) intervened as allowed by law, and other interested parties were allowed to intervene upon petition to the Commission. (see R3 p 437)

Testimony was pre-filed by Aqua. (see R3 pp 436-37; T1 pp 69-01, T2 pp 87-90) The Commission held public hearings from November 2013 through January 2014, during which numerous Aqua customers testified. (R3 pp 435-36) Aqua filed responses to these customer comments. (R2 pp 249-25, 398, 419, 429)

On 17 January 2014, the Public Staff pre-filed testimony, and Aqua filed supplemental direct testimony. On the same date, a nonunanimous Stipulation (not supported by the Attorney General), reflecting agreement on issues between the Public Staff and Aqua, was entered and filed. (R3 p 352) The Commission then held a two-day evidentiary hearing beginning on 27 January 2014. (R3 pp 437-38; R4 pp 632-33)

### **STATEMENT OF GROUNDS FOR APPELLATE REVIEW**

The 2 May 2014 Order constitutes a final order of the Commission in a general rate case, and appeal to the Supreme Court is proper pursuant to N.C. Gen. Stat. § 62-90, N.C. Gen. Stat. § 7A-29(b) and Rule 18 of the North Carolina Rules of Appellate Procedure.

### **STATEMENT OF THE FACTS**

N.C. Gen. Stat. § 62-133.12 became effective on 12 June 2013, shortly before Aqua filed its application seeking approval of the improvement charge mechanism. On 21 August 2013, after Aqua filed its petition, the Public Staff filed a petition

requesting that the Commission establish a rulemaking to implement N.C. Gen. Stat. § 62-133.12 and that the Commission adopt rules establishing procedures for determining and implementing the mechanisms contemplated by the statute. (R4 p 611). When the Commission held the 27 January 2014 hearing on Aqua’s petition, this rulemaking was still pending and rules had not yet been issued.

### The Hearing

At the hearing on Aqua’s petition, a number of witnesses testified and were cross-examined. Aqua’s President and Chief Executive Officer, Thomas Roberts, opined as to the legislative intent of N.C. Gen. Stat. § 62-133.12, saying that when the General Assembly enacted the statute it intended to incentivize water and sewer utilities to invest in needed infrastructure improvements. (R3 pp 446-47; R4 pp 501-02)

Roberts also asserted that allowing the improvement charge mechanism in this instance would help mitigate regulatory lag and was therefore in the public interest. (R4 pp 508-10) In Robert’s view, the mechanism would benefit consumers by creating incremental, “smooth[ed] out” rate adjustments as opposed to the “sharp rate increases that are characteristic of general rate cases.” (R4 p 501)

Roberts initially testified that with adoption of the mechanism there would be a “high likelihood of increasing the intervals between rate cases . . . .” (T1 p 107)

However, on cross-examination, he was unable to give an estimate of this

likelihood. (T1 pp 111-12) On cross-examination, he conceded that we “can’t be sure” there would be fewer rate cases. (T1 p 152)

Roberts also testified regarding Aqua’s three-year plan regarding the system improvement charge. His pre-filed testimony and supplemental testimony incorporated this plan by reference. (see T1 p 81) The three-year plan mentioned generally the need for treatment to address the elevated levels of iron and manganese in water, through either filtration or a liquid sequestering agent. (T1 pp 81-82)

Aqua’s expert witness, Pauline Ahern (a Principal of AUS Consultants), similarly testified regarding “regulatory lag.” She stated that regulatory lag is “crucial for water utilities, including Aqua, as water utilities are the most capital intensive utility industry. . . .” She opined that denial of the improvement charge mechanism would perpetuate the negative impact of regulatory lag upon Aqua’s ability to earn its authorized rate of return, and that denial would impinge upon the company’s ability to provide safe and reliable water service to its customers. (T2 pp 156) She further claimed that adoption of the improvement charge mechanism would improve the capital attractiveness of Aqua to investors, improve services, and provide for more moderate, gradual rate increases. (T2 p 154)

David Furr, Director of the Public Staff Water & Sewer Division, testified that he reviewed Aqua’s three-year plan “in order to formulate the Public Staff’s

preliminary evaluations whether the listed projects were eligible [improvement charge] projects as defined in G.S. 62-133.12(c) and (d).” (T3 p 75) Furr stated that Aqua’s descriptions for each project “were very brief and provided very limited information,” and thus “the Public Staff considered the filed plans to be inadequate.” Even after additional information was obtained through discovery, the detail provided for many of the proposed projects was deficient. (T3 p 76)

As Furr explained, much of the missing detail related to improvements directed toward secondary water quality issues. Because the details provided by Aqua were insufficient, the Public Staff did not have enough information to make the determination whether the improvements were eligible for the mechanism. (T3 pp 88-91)

Over fifty Aqua consumers testified at seven public hearings. Largely, these consumers complained vocally about the combination of having to pay very high rates while, at the same time, receiving very poor water quality. (T1 pp 11-36) Consumers complained about the appearance and odor of their water and the damage the water caused. According to their testimony, the water: (1) is discolored and cloudy and contains sediment; (2) smells of chlorine and/or sulfur; (3) causes damages to appliances and other household property; and (4) stains laundry items and fixtures. Consumers also testified that they do not drink the water and that they are unable at times to use the water for basic, routine functions due to discoloration

and the presence of sediment. Some consumers also complained about low water pressure. (R3 pp 439-40, 451-52)

The Commission admitted into evidence petitions which nine of these consumers brought with them.<sup>1</sup> The petitions complained about Aqua's "escalating costs and higher rates" coupled with "service quality that has improved marginally or not at all." Among other measures, the petitions asked for repeal of N.C. Gen. Stat. § 62-133.12, the statute authorizing implementation of system improvement charges, if the Commission finds them to be in the public interest. These nine petitions contained 691 signatures of Aqua consumers living in multiple subdivisions.

In addition to the nine petitions which were admitted for Commission consideration, petitions containing the same language and signed by hundreds of other Aqua consumers were sent to the Commission and/or the Public Staff. Hundreds of Aqua customers also submitted emails and letters to Aqua, the Public

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<sup>1</sup> Eight of the nine petitions, identified in the List of Exhibits And Other Papers Necessary To An Understanding Of The Issues On Appeal And Separately Docketed, located at R4 pp 631-633, are as follows: Official Exhibits of Public Hearing Held 11.14.2013, Newton, Sides Exhibit 1, 1/A; Official Exhibits of Public Hearing Held 11.21.2013, Raleigh Part 1, Stoeher Exhibit 1, Loughran Exhibit 2; Official Exhibits of Public Hearing Held 12.12.13, Wilmington, Gershowitz Exhibit 1; Official Exhibits of Public Hearing Held 12.17.13, Charlotte, Coleman Exhibit 3, Wick Exhibit 1, Morales Exhibit 4; Official Exhibits of Evidentiary Hearing Held 1.27.14, Raleigh, Stevenson Exhibit 1. The ninth petition, accompanying the testimony of witness Wells on 11.21.13 in Raleigh, is identified as Wells Exhibit 1 but is missing.

Staff and the Commission, complaining about water quality and high water and sewer rates.<sup>2</sup>

Page limitations make it infeasible to repeat in detail all of the vocal consumer complaints lodged against Aqua, but here are a few examples. David Baxter, an Aqua consumer who recently moved from Concord to Charlotte, testified as to the high rates and poor water quality. In Concord, he paid approximately \$30-\$35 per month for water and sewer whereas the rates he pays Aqua are much higher, about \$100 per month for water and sewer. (R4 p 631, Charlotte Hearing T p 96) He testified that, even at these high prices, the quality of drinking water supplied by Aqua was so poor that he often had to buy his drinking water from the store. (R4 p 631, Charlotte Hearing T p 95-100)

Likewise, Aqua consumer Brian LiVecchi testified about discolored water and “black flecks adhering to the faucet.” He presented pictures of sediment in his bathtub; he stated that when he had called Aqua to complain, he was told to flush his water heater; he stated he would have to flush his water heater about once a week in order to achieve a level of water quality that anyone would find acceptable; when he called Aqua, he received a belligerent response. (T1 pp 49-53)

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<sup>2</sup> See e.g. <http://starw1.ncuc.net/NCUC/ViewFile.aspx?Id=78245f9b-9e5c-476d-a626-bca18e0080ad> ; <http://starw1.ncuc.net/NCUC/ViewFile.aspx?Id=d52c38b7-0730-44ff-a201-05c18bfc9ff4> ; <http://starw1.ncuc.net/NCUC/ViewFile.aspx?Id=bfb8d61b-0bd5-4927-b864-8f91f9b53086> <http://starw1.ncuc.net/NCUC/ViewFile.aspx?Id=93af4432-7327-40be-96bc-68b67ec836f7>

When Aqua witness Roberts was asked whether such service was adequate, he responded, “Certainly Mr. LiVecchi viewed it as inadequate.” Then, unsolicited, Roberts proceeded to characterize LiVecchi’s testimony as consistent with the “very vocal and voluminous” complaints of other customers about water quality issues. When pressed, he conceded that the service to LiVecchi was not adequate. (T2 pp 34-35)

### The Commission’s Order and Public Interest Determination

Following the hearing, the Commission, in its 2 May 2014 Order, allowed Aqua to adopt the improvement charge mechanism, finding that it was in the public interest.

As a procedural matter, in the Stipulation, Aqua and the Public Staff recommended two alternatives for the Commission regarding the fact that Aqua had petitioned for a system improvement charge while the Commission’s rulemaking was still pending and rules had not been adopted: (1) that the Commission hold the docket open because the final rules had not yet been approved. (T2 p 76); (2) that the Commission adopt procedures allowing the company to “make the requisite filings and, upon receiving approval, implement the system improvement charges under the rules adopted by the Commission without having to make an additional rate filing.” (R3 pp 362-63)

In its Order, the Commission decided not to leave the docket open, adopting, instead, alternative procedures which would allow Aqua to make the requisite filings and qualify for implementation of the system improvement charges without having to make an additional rate case filing subsequent to the adoption of final rules. (R3 p 448) These alternative procedures are set forth in Appendices C and D of the Order, and largely track the proposed rules which Aqua and the Public Staff had submitted in their Joint Motion. (R4 pp 561-70, 597-610)

With respect to its public interest determination (which is the subject of the instant appeal), the Order discusses a purported public policy underlying N.C. Gen. Stat. § 62-133.12 and ultimately adopts Aqua witness Roberts' view that the General Assembly enacted N.C. Gen. Stat. § 62-133.12 to incentivize water and sewer utilities to invest in needed infrastructure improvements. (R3 pp 446-47; R4 pp 501-02) “The enactment was intended to encourage and accelerate investment in needed water and sewer infrastructure by means of a mechanism which will alleviate the effects of regulatory lag by allowing for earlier recovery of some portion . . . of the incremental depreciation expense and capital costs associated with eligible investments in water and sewer infrastructure projects. . . .” (R3 p 446; R4 p 508)

The Order also characterizes “regulatory lag” as a significant problem for water and sewer utilities, adopting Aqua’s assertion that allowing the improvement

charge mechanism would help mitigate regulatory lag and is therefore in the public interest. (R4 pp 508-10) According to the Order, regulatory lag poses a significant problem in capital-intensive industries such as water utilities, due to: (1) the time it takes to process general rate cases; (2) commission regulatory policies; and (3) the extended construction times for major capital projects. (R4 pp 508-09)

The Order also accepts Aqua witness Roberts' view that the mechanism would benefit consumers by creating incremental, "smooth[ed] out" rate adjustments as opposed to the "sharp rate increases that are characteristic of general rate cases." (R4 p 501) In addition, the Order repeatedly emphasizes that the mechanism would allow for "expedited recovery," expedited investment, and, ultimately, expedited construction of system improvements. (R3 pp 446-47; R4 pp 509-10)

The Order also discusses Aqua's secondary water quality and how that pertains to its decision regarding the improvement charge mechanism. (R3 pp 439-40, 446, 448, 451-55; R4 pp 501-02, 508, 510-11) The Order notes that, during the public hearings, Aqua customers complained about the appearance and odor of their water and the damage the water caused. (R3 pp 439-40, 451-52) Nonetheless, the Order concludes that the overall quality of service provided by Aqua to its customers is "adequate." (R3 p 440)

The Order qualifies its assessment that Aqua's overall quality of service is adequate by noting that "[a]dditional attention is required to address the issues which arise from elevated levels of naturally occurring iron and manganese in the source water supply in certain Aqua systems." (R3 p 440)

The Order accepts Aqua witness Roberts' view that the improvement charge mechanism is the most effective and efficient funding mechanism by which Aqua could address these "secondary" water quality issues. (T1 p 77) Roberts contended, and the Commission agreed, that approval of the improvement charge mechanism was in the public interest because the mechanism would incent Aqua to both increase and accelerate improvements which would reduce the secondary water quality problems. (R4 pp 501-02, T1 pp 137, 170-71) The Order states that there should be future collaboration between Aqua and the Public Staff "to develop and implement a plan to identify and respond to secondary water quality concerns" in the individual subdivision service areas. (R3 p 448) Similarly, with respect to Public Staff's testimony regarding Aqua's insufficient and inadequate three-year plan, the Order states that "Aqua and the Public Staff should be able to work together to establish the level of detail to be provided to the Commission concerning its initial three-year plan." (R4 p 512)

## STANDARD OF REVIEW

N.C. Gen. Stat. § 62-94(b) sets forth the standard of review of a North Carolina Utilities Commission decision and provides that this Court:

may reverse or modify the decision if the substantial rights of the appellants have been prejudiced because the Commission's findings, inferences, conclusions or decisions are:

- (1) In violation of constitutional provisions, or
- (2) In excess of statutory authority or jurisdiction of the Commission, or
- (3) Made upon unlawful proceedings, or
- (4) Affected by other errors of law, or
- (5) Unsupported by competent, material and substantial evidence in view of the entire record as submitted, or
- (6) Arbitrary or capricious.

N.C. Gen. Stat. § 62-94(b) (2011); *see also State ex rel. Utils.Comm'n v. Pub. Staff*, 322 N.C. 689, 698, 370 S.E.2d 567, 573 (1988) (“*Duke Power II*”).

The Commission, in order to facilitate appellate review, must comply with N.C. Gen. Stat. § 62-79(a), which provides that:

All final orders and decisions of the Commission shall be sufficient in detail to enable the court on appeal to determine the controverted questions presented in the proceedings and shall include: (1) 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. Gen. Stat. § 62-79(a).

The test on appeal is whether the Commission's Order deciding that the improvement charge mechanism is in the public interest "contained sufficient findings of fact to demonstrate that it was supported by competent, material and substantial evidence in view of the entire record." *State ex rel. Utils. Comm'n v. Cooper*, 366 N.C. 484, 485, 739 S.E.2d 541, 542 (2013). Substantial evidence "means such relevant evidence as a reasonable mind might accept as adequate to support a conclusion." *Id.* at 366 N.C. at 490, 739 S.E.2d 545. *State ex rel. Utils. Comm'n v. Carolina Util. Customers Ass'n*, 348 N.C. 452, 460, 500 S.E.2d 693, 699-00 (1998) (CUCA II).

Findings of fact are not supported by competent, material, and substantial evidence if the Commission's order does not include all necessary findings of fact. "Failure to include all necessary findings of fact is an error of law and a basis for remand under section 62-94(b)(4) because it frustrates appellate review." *Id.*

In addition, findings of fact are not supported by competent, material, and substantial evidence if the Commission's ultimate reasoning does not appear in the order or is not supported by the Commission's chain of reasoning. "Evidence must support findings; findings must support conclusions; conclusions must support the judgment." *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)).

## ARGUMENT

I. **THE COMMISSION’S ORDER FINDING THAT THE IMPROVEMENT CHARGE MECHANISM IS IN THE PUBLIC INTEREST DOES NOT CONTAIN SUFFICIENT FINDINGS, REASONING AND CONCLUSIONS; DOES NOT ADEQUATELY WEIGH AND CONSIDER RELEVANT, MATERIAL FACTORS BEARING ON THE PUBLIC INTEREST; AND IS NOT SUPPORTED BY COMPETENT, MATERIAL AND SUBSTANTIAL EVIDENCE.**

Aqua is a monopoly utility which provides essential water services to captive customers. Unlike typical companies, Aqua does not have its prices constrained by competition or market forces. Instead, the Commission regulates Aqua’s charges and provides the only protection that North Carolina consumers have against unreasonable charges and abuses of monopoly power.

Consistent with this duty to protect the public, the General Assembly, in enacting N.C. Gen. Stat. § 62-133.12, made clear that the Commission must consider proposed improvement charge mechanisms on a case-by-case basis (“in a general rate case proceeding”) and can only allow such mechanisms to be adopted if the Commission specifically finds the mechanism to be in “the public interest” under the circumstances of the particular utility and its consumers. By its plain language, the statute does not constitute a blanket authorization of improvement charge mechanisms at the whim of the utility or provide the Commission with unfettered discretion to grant improvement charge mechanisms. Likewise, by its plain language, the statute provides that the proper inquiry for the Commission is

not whether adoption of the mechanism is in the interest of utility (here, Aqua), but whether adoption of the mechanism is in the interest of the general public.

In the absence of an improvement charge mechanism, a water utility must generally obtain rate increases through a general rate case where normal ratemaking procedures apply. An improvement charge mechanism allows a utility like Aqua to bypass these normal procedures so that it can recover costs and implement periodic rate increases with increased frequency and reduced review and scrutiny. Some commentators have noted that these type of mechanisms tend to skew the balance that traditional ratemaking strikes between consumers and utility shareholders by placing undue emphasis on cost recovery for the utility and failing to take account into cost decreases and other factors that may offset cost increases (which, in theory, would normally be considered in a typical general rate case proceeding). *See, e.g.*, Lino Mendiola, “The Erosion of Traditional Ratemaking Through the Use of Special Rates, Riders, and Other Mechanisms,” 10 Tex. Tech. Admin. L. J., Vol. 10, No. 1, 173 (Fall 2008) .

Thus, the improvement charge mechanism authorized by the Commission provides Aqua with more frequent opportunities to obtain cost recovery and rate increases. From the standpoint of Aqua’s consumers, however, the mechanism is burdensome because it provides the virtual certainty of continued and more frequent rate increases – when Aqua’s rates are already very high and its consumers have

already been hit with a number of rate increases during challenging economic times - without any certainty whatsoever that Aqua will improve its poor water quality.

In light of this backdrop, the Commission should have scrutinized Aqua's request for an improvement charge mechanism with public interests paramount in its consideration, and with an eye towards determining whether the general public and Aqua's consumers would receive any concrete benefits as a result of the mechanism. Instead, the Commission's Order determines that adoption of the mechanism is in the public interest, but without reaching sufficient findings and conclusions, utilizing flawed reasoning regarding the purported public policy of the statute, and ultimately relying on mere speculation instead of sufficient evidence in the record. As discussed in greater detail below, the Commission's Order was legally insufficient and should be reversed.

**A. The Commission's Order Was Required to Have Sufficient Findings and Conclusions and Was Required to Weigh and Consider All Relevant and Material Factors Bearing on the Public Interest.**

The critical issue before the Commission was whether Aqua satisfied its burden of showing that the improvement charge mechanism was in the public interest. N.C. Gen. Stat. § 62-133.12(a). The burden of proof rested with Aqua. This is implicit in the statute and made explicit in the procedures which the Commission established for Aqua as contained in Appendices C and D of its Order. Subpart (L) of these procedures states, "[t]he burden of proof as to whether [the

mechanism] is in the public interest, the correctness and reasonableness of any [mechanism, and whether the investment in the . . . system improvements was reasonable and prudently incurred shall be on the Company.” (R4 pp 565, 570)

North Carolina law governing utilities and the Commission’s authority provide that the Commission’s public interest determination must contain sufficient findings and conclusions and must weigh and consider all relevant and material factors bearing on the public interest. While the present case involves a determination made under a newly enacted statute and there are currently no published appellate cases interpreting that statute, general legal principles that apply to utility cases and rates are informative.

This Court has reversed Commission decisions when the Commission’s decision lacks sufficient “factual underpinnings upon which the Commission’s conclusion . . . rests.” *State ex rel. Utils. Comm’n v. Pub. Staff*, 322 N.C. at 698, 370 S.E.2d at 572-73 (“*Duke Power II*”) (Commission was found to have erred in making sufficient material factual findings necessary to support its conclusion that 13.4% was a fair rate of return on common equity); *see also State ex rel. Utils. Comm’n v. Cooper*, 366 N.C.484, 739 S.E.2d 541 (2013) (Commission’s decision with respect to return on equity was reversed and remanded due to Commission’s failure to make findings of fact regarding the impact of changing economic conditions on customers).

The Commission is charged with fixing “such rates as shall be fair both to the public utilities and to the consumer.” N.C. Gen. Stat. § 62-133(a). This Court has long recognized that, when the Commission sets rates, fairness to the consumers is as important, if not more important, than fairness to the utility. *See, e.g., State ex rel. Utils. Comm’n v. General Tel. Co.* 285 N.C. 671, 680, 208 S.E.2d 681, 687 (1974) (“The primary purpose of Chapter 62 of the General Statutes is not to guarantee to the stockholders of a public utility constant growth in the value of and in the dividend yield from their investment, but is to assure the public of adequate service at a reasonable charge.”)<sup>3</sup>

This Court has held that the Commission must consider not only “those specific indicia of a utility’s economic status set out in G.S. 62-133(b), but also all other material facts of record which may have a significant bearing on the determination of reasonable and just rates.” *State ex rel. Utils. Comm’n v. Thornburg*, 314 N.C. 509, 511, 334 S.E.2d 772, 773 (1985) (citations omitted). Specifically, when the Commission assesses whether rates are reasonable, it must

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<sup>3</sup> The “public interest” requirement contained in § 62-133.12(a) is similar to the “public convenience and necessity” requirement present in other sections of Chapter 62. *See State ex rel. Utils. Comm’n v. Village of Pinehurst*, 99 N.C. App. 224, 229, 393 S.E.2d 111, 115 (1990), *aff’d on other grounds*, 331 N.C. 278, 415 S.E.2d 199 (1992) (When the Commission is adjudging public convenience and necessity in the context of proposed transfers of water and sewer franchises under G.S. § 62-111(a), it must “inquire into *all* aspects of anticipated service and rates occasioned and engendered by the proposed transfer, and then determine whether the transfer will serve the public convenience and necessity”).

determine the weight and sufficiency of the evidence and appraise conflicting and circumstantial evidence. *Id.* at 515, 334 S.E.2d at 775.

The Commission is not allowed to ignore such evidence about adequacy of service when considering whether to raise rates and when determining the reasonableness of rates. *State ex rel. Utils. Comm'n v. Morgan*, 277 N.C. 255, 266-267, 177 S.E.2d 405, 412-413(1970); *General Tel. Co.* 285 N.C. at 681, 208 S.E.2d at 687.

This obligation to weigh and consider the evidence is not altered by a nonunanimous stipulation. When, as here, the Commission is presented with a nonunanimous stipulation (R3 p 451), it “must consider the nonunanimous stipulation along with all the evidence presented and any other facts the Commission finds relevant to the fair and just determination of the proceeding.” *State ex rel. Utils. Comm'n v. Carolina Util. Customers Ass'n*, 348 N.C. at 466, 500 S.E.2d at 703 (*CUCA II*). The Commission must remain mindful that a nonunanimous stipulation does not “shift . . . the burden of proof from the utility to the opponents of the stipulation.” *Id.* at 464, 500 S.E.2d at 702.

As with other utility-related decisions, public interest determinations made by the Commission must contain sufficient analysis, findings, and conclusions. For example, in *State ex rel. Utils. Comm'n v. Carolina Util. Customers Ass'n*, 336 N.C. 657, 446 S.E.2d 332 (1994) (“*CUCA I*”), a case involving a similar, newly

adopted statute designed to stimulate construction of natural gas facilities and extension of services in areas un-served by existing utilities, this Court made clear that the Commission must engage in detailed analysis and consider all relevant, material factors in the record when tasked with deciding whether the public interest is being served. In that case, this Court found substantial evidence in the record supporting the Commission’s conclusion that a special “expansion fund,” created by N.C. Gen. Stat. § 62-158 and used to construct facilities in territory where construction would otherwise be infeasible, was in the public interest. The Commission heard testimony from numerous witnesses who were knowledgeable about the economic impact of natural gas facilities on local economies. This testimony, in turn, was supported by written reports and studies, “replete with empirical data,” which the Commission also considered. *Id.* at 666-69, 446 S.E.2d at 338-39.

The above-cited decisions of this Court make clear that where the Commission’s findings and conclusions on public interest are not supported by competent, material and substantial evidence in the record, this Court should reverse the Commission’s decision and remand the case for complete fact-finding and analysis by the Commission.

**B. The Order’s Public Policy Rationale is Flawed, Inconsistent with the Plain Language of N.C. Gen. Stat. § 62-133.12, and Provides an Improper Basis for Concluding that Aqua’s Improvement Charge Mechanism is in the Public Interest.**

Throughout its Order and public interest decision, the Commission repeatedly resorts to recitation of what it – and Aqua witness Roberts - believes to be the overall public policy underlying N.C. Gen. Stat. § 62-133.12 as justification for allowing Aqua to adopt the improvement charge mechanism in this particular matter. “The enactment was intended to encourage and accelerate investment in needed water and sewer infrastructure by means of a mechanism which will alleviate the effects of regulatory lag by allowing for earlier recovery of some portion . . . of the incremental depreciation expense and capital costs associated with eligible investments in water and sewer infrastructure projects. . . .” (R3 p 446; R4 p 508)

However, the Commission’s public policy justification is circular and flawed, and would seem to justify granting an improvement charge mechanism to any utility that requested it, which is plainly not what the statute contemplates. The Commission, in essence, is reading out of the statute the requirement that the Commission make the public interest determination on a case-by-case basis (“in a general rate case proceeding”) in light of the particular circumstances of that utility and its consumers. Under the Commission’s public policy rationale, which seems to state that all system improvement charges are justified, it is difficult to see how the Commission would ever find any basis for deciding that a system improvement charge was not in the public interest. This analysis is circular, flawed, and

erroneous because public policy *qua* public policy does not, in and of itself, provide sufficient rationale justifying adoption of the mechanism in a particular matter.

The General Assembly, when it enacted the statute, specifically gave the public interest determination to the Commission to make in the context of a request made by a particular utility in general rate case proceeding, when all aspects of the utility's costs and quality of service could be evaluated. The Commission cannot just punt away that determination or attempt to punt it back to the General Assembly by merely citing to the statute that the General Assembly passed. Thus, the Commission's general, overly broad public policy rationale for its public interest determination is inconsistent with the plain language of N.C. Gen. Stat. § 62-133.12, and constitutes an improper conclusion that the Commission reached on the public interest determination, rendering its decision legally deficient.

**C. The Order's Regulatory Lag Rationale Does Not Provide a Proper Basis For its Public Interest Determination.**

For similar reasons, the Order's discussion regarding "regulatory lag" does not provide a proper underpinning for the Commission's public interest determination either. The Order, in broad and general fashion, asserts that regulatory lag is a problem in capital-intensive industries such as water utilities, pointing to three causes: (1) the time it takes to process general rate cases, (2) "commission regulatory policies," and (3) the extended construction times for major capital projects. (R4 pp 508-09)

First, the Order only speaks of regulatory lag generally and not specifically as it may pertain to Aqua. For example, the Commission does not discuss whether there has been undue time involved in processing Aqua's general rate cases; the Commission does not identify any particular "commission regulatory policies" that may have contributed to regulatory lag; the Commission does not specify what "extended construction times" might be at issue and for what "major capital projects."

More importantly, the Order does not provide appropriate findings or conclusions as to how fixing the so-called regulatory lag problem serves the public interest, as opposed to Aqua's interest. At most, the Order's conclusions are speculative in this regard in that there appears to be some vague, undefined hope that if regulatory lag is alleviated Aqua might be more likely to improve water quality.

Of note, in this proceeding the Commission specifically denied a request that it conduct or order a study examining the effect and benefits of improvement charge mechanisms on consumers in states where similar mechanisms are already in place. (R4 p 514) Likewise, the Commission denied a request that it order Aqua to undergo a focused management audit to better understand how Aqua is currently making its investment decisions to address water quality issues and determine why

prior rate increases and investment decisions have not resulted in acceptable water quality. (R4 pp 508, 516)

Had the Commission granted these requests and had the benefit of this type of information, it would have been in a better position to make a determination based on empirical evidence as opposed to relying on mere speculation. The Commission's approach here stands in stark contrast to the public interest determination made by the Commission (and upheld by this Court) in *CUCA I* where the Commission considered written reports and studies "replete with empirical data." *Id.* at 666-69, 446 S.E.2d at 338-39. Here, the Commission's Order contains almost nothing in the way of empirical data or concrete evidence, at least in terms of concrete benefits to the general public, largely because Aqua offered only minimal and generalized evidence. (R3 p 446; R4 p 508; T2 pp 154-57)]

Rather than consider and carefully weigh the actual benefits and disadvantages of the improvement charge mechanism as shown in other states where it has been utilized, the Commission relied on a speculative and selective public policy rationale. While alleviation of regulatory lag might be in Aqua's interest, the Commission did not provided any sufficient findings or conclusions showing it was in the public interest. As with the Commission's overall public policy justification discussed above, the Commission's conclusion regarding the

alleviation of regulatory lag is flawed and circular and would seemingly justify adoption of an improvement charge mechanism whenever requested by a utility. Again, this analysis is inconsistent with the framework set forth in N.C. Gen. Stat. § 62-133.12 and renders its public interest determination legally deficient.

**D. The Commission’s Conclusion That Adoption Of The Improvement Charge Would “Smooth Out” Rates And Result In Fewer Rate Cases Is Flawed, Not Based On Sufficient Evidence, And Does Not Provide An Appropriate Basis For Determining That The Mechanism Is In The Public Interest.**

The Order also relies on Aqua testimony contending that the improvement charge mechanism would create incremental, smoothed-out rate adjustments as opposed to sharp rate increases characteristic of general rate cases, and that there would be fewer rate cases and longer time between rate cases. (R4 p 501; T1 pp 82, 86, 107; T2 p 154)

Initially, it is worth noting that “smoothing out” does not mean that consumers will see lower rates; it simply means that, as a matter of timing, they will see incremental rate increases more frequently.

Moreover, a close review of the record reveals that even the testimony from Aqua’s witness was equivocal about these claimed benefits to the public. Aqua witness Roberts initially testified that with adoption of the mechanism there would be a “high likelihood of increasing the intervals between rate cases . . . .” (T1 p 107) However, on cross-examination, he was unable to give an estimate of this

likelihood. (T1 pp 111-12) and conceded that we “can’t be sure” there would be fewer rate cases. (T1 p 152) Similarly, when Public Staff witness Katherine Fernald was asked about the likelihood that the mechanism would result in fewer rate filings by Aqua, she alluded to Roberts’ prior testimony and could only answer, “It’s possible.” (T3 p 204) The Order glosses over this equivocation. (R4 p 501)

Regardless, notwithstanding the speculation regarding a purported benefit to Aqua’s consumers of this “smoothing out” of rate increases, there was simply no indication in this proceeding that Aqua’s consumers – who complained vigorously about the combination of already high rates coupled with poor water quality – would find a “smoothing out” of rate increases to be of any real benefit to them. Ultimately, with respect to the ultimate question of whether the mechanism is in the public interest, the Commission failed to weigh and consider the most important issues affecting Aqua’s customers: the fact that customers’ rates will increase; the fact that this increase will occur because the mechanism requires costs to be borne by Aqua’s customers; the fact that rates will increase with more frequency. (R3 pp 446-47; R4 p 511; T1 pp 111-12, 155)

Such omissions in the Commission’s analysis are very basic, in that:

(1) The Commission determined that the mechanism is in the public interest on the purported grounds that Aqua’s consumers indicated a desire for improved water quality, while not giving weight to the fact that Aqua’s customers filed many

written complaints objecting almost unanimously to any rate increase. (T1 pp 23-36; R3 pp 446-47; R4 pp 510-11)

(2) The Commission determined that Aqua's customers will supposedly benefit by receiving rate increases sooner so as to "smooth out" anticipated rate increases, while not giving weight to the fact that Aqua's customers have already been subjected to multiple rate cases in recent years and informed the Commission that they did not want rate increases sooner. (T1 pp 23-36; R4 p 501, See Footnotes 1 and 2, p 7-8)

Once again, the Order's "smoothing out" rationale would seemingly justify granting an improvement charge mechanism any time a utility requested one, which is not consistent with the framework set forth in N.C. Gen. Stat. § 62-133.12, does not constitute the case-by-case public interest determination contemplated by the statute, and renders the Commission's public interest determination legally deficient.

**E. The Order's Conclusion That The Improvement Charge Mechanism Would Incentivize Aqua To Improve Water Quality Is, At Most, Speculative, Not Based On Sufficient Evidence, And Does Not Provide An Appropriate Basis For Its Public Interest Determination.**

The Order, relying on Aqua's testimony, concludes that the improvement charge mechanism would incentivize Aqua to improve water quality. This conclusion is, at most, speculative in that no concrete obligation, commitment, or

anything else actually ensuring that water quality would improve was imposed or is contained in the Order. The speculative nature of this conclusion is highlighted by the fact that the Commission denied a request that it order Aqua to undergo a focused management audit to better understand how Aqua is currently making its investment decisions to address water quality issues and to determine why prior rate increases and investment decisions have not resulted in acceptable water quality. (R4 pp 508, 516). Lacking this information, which might have shed some light on why the prior rate increases and Aqua's already high rates have not resulted in improved water quality, there is no empirical basis for the Commission to conclude that yet more rate increases, with more frequency, will actually bear fruit for the public and lead to water quality improvements.

As a utility that has received a monopoly from the state, it is Aqua's duty to provide appropriate water quality at a reasonable price for consumers. Under N.C. Gen. Stat. § 62-42(a), the Commission is already empowered to require Aqua to provide clean, drinkable water and take appropriate, corrective action with respect to water quality. The Commission has, among other things, the lawful power to deny an otherwise justified rate increase for a utility if the utility is not providing adequate service. *State ex. rel. Util Comm. v. Gen. Tel. Co.*, 285 N.C. 671, 680-81, 208 S.E.2d 681, 687-88 (1974).

It was incumbent upon the Commission to recognize that it has other regulatory tools it could use to try to compel or incent Aqua to provide better water quality. It is insufficient for the Commission to conclude that the improvement charge mechanism is in the interest of the general public based on mere speculation that such mechanism might incentivize Aqua to improve water quality, especially in the absence of any binding commitment or obligation imposed by the Commission in this regard. Thus, while Aqua receives the certain and concrete benefit of more frequent rate increases on a faster time frame with less scrutiny, the public only receives a vague hope that the mechanism might incent Aqua to do something about water quality. This does not constitute a sufficient finding or conclusion regarding the public interest.

**F. The Three-Year Plan Submitted By Aqua Was Acknowledged To Be Insufficient And Inadequate. The Commission's Decision To Grant The Mechanism Without The Benefit Of Such Essential Information Was Therefore Based On Insufficient Evidence In The Record And Was Unsupported By Substantial Evidence.**

The Order finds Aqua's proposed improvement charge mechanism to be in the public interest, even while recognizing that Aqua's three-year plan for the mechanism was insufficient and inadequate. This alone shows that the Order's public interest determination does not contain appropriate findings and conclusions and was based on an insufficient record.

Public Staff witness Furr testified that Aqua's descriptions for each project "were very brief and provided very limited information," and thus "the Public Staff considered the filed plans to be inadequate." (T3 p 76) Even after additional information was obtained through discovery, the detail provided for many of the proposed projects was deficient. (T3, p 81) Much of the missing detail related to improvements directed toward secondary water quality issues, one of the very supposed benefits to the general public that the Order speculates might occur as a result of the improvement charge mechanism. (T3, p 88)

Aqua's three-year plan was, or should have been, a factor which the Commission carefully examined as it considered whether the improvement charge mechanism was in the public interest. It is through this plan that the company was expected to provide a preview of what the mechanism would do over time and the impact it would have, i.e., a "detailed description" about eligible water and sewer system improvements expected to be completed in the initial period, including an estimate of the cost of the improvements and dates when the improvements will be placed into service. (See R4 pp 619, 625, the system improvement charge rules ultimately adopted by the Commission).

However, the Order grants approval for the improvement charge mechanism, finding it is in the public interest, despite the obvious inadequacy and incompleteness of the plan. (R4 p 512; T3 pp 76, 81) The Order does not take

issue with the Public Staff's assessment that Aqua's plan was insufficient and inadequate. Indeed, the Order notes the inadequacy of both the initial three-year plan and the supplemental data. (R4 pp 505, 512; T pp 76, 81). But instead of requiring Aqua to submit a better plan or require Aqua to do something else that would provide the Commission with more information or more assurances regarding public interest benefits, the Order just optimistically speculates that Aqua and the Public Staff "should be able to work together to establish the level of detail to be provided to the Commission concerning its initial three-year plan." (R4 p 512)

This statement should be recognized for what it is – a plain indication that the record on which the Order relied was insufficient. With such critical evidence missing from the record, the Commission's decision to move forward and approve the mechanism is arbitrary and capricious. *See State ex rel. Utils. Comm'n v. Thornburg*, 314 N.C. 509, 515, 334 S.E.2d 772, 776 (1985). Why the rush to adopt the mechanism in the absence of a sufficient plan? The insufficiency of the plan shows that Aqua failed to meet its burden of proof to show that the proposed mechanism was in the public interest and shows that the Commission's public interest determination was legally erroneous. (R4 pp 565, 570)

The Order does not cure these failures or errors with its expectation that Aqua and the Public Staff will "work together" on the matter going forward. (R4

pp 519-520; R3 p 448) Such future collaboration does not constitute any evidence, let alone substantial evidence, in the existing record. Ultimately, the Order's approach in this regard simply highlights the fact that the Order engages in speculation when it determines that the mechanism is in the public interest, as opposed to basing that determination on sufficient and appropriate findings and conclusions that are supported by the evidence in the record.

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In sum, when the General Assembly enacted N.C. Gen. Stat. § 62-133.12, it made concern for the public interest paramount and required the Commission to make case-by-case public interest determinations in general rate case proceedings.

The Order's findings and conclusions on the public interest determination here are flawed and legally insufficient. The Commission's overriding view that the underlying public policy of N.C. Gen. Stat. § 62-133.12 supports adoption of the mechanism for Aqua is circular and contrary to the plain language of the statute, which requires a public interest finding under the individual circumstances of the case at hand as opposed to a blanket finding that would justify a public interest finding no matter what the individual circumstances. The Order's public interest determination is not justified by the Order's conclusions that the improvement charge mechanism will fix regulatory lag, "smooth out" rate increases, and incent Aqua to improve water quality because the Order does not show how any of those

things will concretely benefit Aqua's consumers (as opposed to Aqua) and, at most, engages in mere speculation that is not based on any sufficient, empirical evidence. The Order's insufficient findings and conclusions, and Aqua's failure to meet its burden of proof, are highlighted by the fact that the Order finds the mechanism to be in the public interest, even while acknowledging that the three-year plan submitted by Aqua regarding the mechanism was insufficient and inadequate.

The benefit of the improvement charge mechanism may be concrete and certain as it pertains to Aqua in that it will be able to impose more frequent rate increases without having to go through the normal procedures inherent in a case. However, notwithstanding the fact that N.C. Gen. Stat. § 62-133.12 plainly provides that the proper inquiry for the Commission is whether the mechanism is in the public interest, the Order does not place public interests on the same footing as Aqua's interests and the Order contains no findings and conclusions that point to any concrete benefits to the general public.

For the foregoing reasons, the Commission erred legally when it determined that the improvement charge mechanism was in the public interest.

### **CONCLUSION**

The Attorney General respectfully requests that the North Carolina Utilities Commission's Order Granting General Rate Increase be vacated and remanded for further proceedings.

Respectfully submitted, this the 24th day of November, 2014.

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**CERTIFICATE OF SERVICE**

The undersigned hereby certifies that the foregoing ***BRIEF OF INTERVENOR-APPELLANT ATTORNEY GENERAL ROY COOPER*** has been filed with the Court's electronic filing system and has been served upon ***APPELLEES*** by electronic mail, addressed to counsel of record as follows:

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