Nos. 271A18 & 401A18

SUPREME COURT OF NORTH CAROLINA

****

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

STATE OF NORTH CAROLINA ex rel. UTILITIES COMMISSION; DUKE ENERGY CAROLINAS, LLC, Applicant, Appellees, v. ATTORNEY GENERAL JOSHUA H. STEIN, Intervenor; SIERRA CLUB, Intervenor; NORTH CAROLINA SUSTAINABLE ENERGY ASSOCIATION, Intervenor; NORTH CAROLINA JUSTICE CENTER, NORTH CAROLINA HOUSING COALITION, NATURAL RESOURCES DEFENSE COUNCIL, and SOUTHERN ALLIANCE FOR CLEAN ENERGY, Intervenors, Appellants, PUBLIC STAFF—NORTH CAROLINA UTILITIES COMMISSION, Intervenor, Cross-Appellant.	)	From the North Carolina Utilities Commission

****

INTERVENOR-APPELLANT
ATTORNEY GENERAL'S BRIEF

****

INDEX

TABLE OF AUTHORITIES

Cases — Page(s)

Codified Statutes

Session Laws

Commission Orders

Other Authorities

Agency Rules

Nos. 271A18 & 401A18

SUPREME COURT OF NORTH CAROLINA

****

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

STATE OF NORTH CAROLINA ex rel. UTILITIES COMMISSION; DUKE ENERGY CAROLINAS, LLC, Applicant, Appellees, v. ATTORNEY GENERAL JOSHUA H. STEIN, Intervenor; SIERRA CLUB, Intervenor; NORTH CAROLINA SUSTAINABLE ENERGY ASSOCIATION, Intervenor; NORTH CAROLINA JUSTICE CENTER, NORTH CAROLINA HOUSING COALITION, NATURAL RESOURCES DEFENSE COUNCIL, and SOUTHERN ALLIANCE FOR CLEAN ENERGY, Intervenors, Appellants, PUBLIC STAFF—NORTH CAROLINA UTILITIES COMMISSION, Intervenor, Cross-Appellant.	)	From the North Carolina Utilities Commission

****

INTERVENOR-APPELLANT
ATTORNEY GENERAL'S BRIEF

****

ISSUES PRESENTED

I. Did the Utilities Commission err by requiring Duke's customers to pay to close Duke's coal-ash basins and to remediate the pollution that flowed from those coal-ash basins?

II. Did the Utilities Commission err by allowing Duke to receive a return on, and therefore profit from, the cost of closing its coal-ash basins?

INTRODUCTION

For decades, when Duke Energy's power plants generated coal ash, Duke mixed that ash with water and then put it into unlined ponds. Duke continued this practice even after it learned that the practice would pollute this state's groundwater. Those actions by Duke have caused massive pollution—pollution that is still being cleaned up today. These appeals ask whether consumers should be compelled to pay to clean up Duke's mismanagement of its coal ash.

In the proceedings below, the Utilities Commission held that Duke's clean-up costs should indeed fall on consumers. It even ordered consumers to pay Duke a return on these costs, allowing Duke to profit from cleaning up the pollution that it caused. Those decisions strayed far from the law.

Years ago, Duke discovered that when it kept coal ash in unlined ponds, it was violating the law by polluting groundwater or would eventually

do so. Despite this discovery, Duke did nothing to stop its coal ash from polluting this state's groundwater. It rejected the advice of its own internal experts, who said that storing coal ash in unlined ponds was the riskiest option of all.

After storing its coal ash in an unsafe way, Duke made matters worse by failing to maintain its coal-ash ponds properly. At its Dan River plant, for example, Duke refused two requests from its engineers to inspect an aging pipe that ran under one of the coal-ash ponds. In February 2014, that pipe failed, causing tens of thousands of tons of coal ash to flow into the Dan River.

The Dan River spill may be the most notorious example of the pollution that Duke's coal ash has inflicted on this state, but it is far from the only one. Duke's monitoring wells have recorded almost six thousand test results that show violations of state groundwater rules. As a result of the Dan River spill and other illegal discharges of coal-ash pollution, Duke also pleaded guilty to nine criminal violations of the Clean Water Act.

In 2014, in the aftermath of the Dan River spill, the General Assembly responded to Duke's actions by enacting a statute that tells Duke how to clean up its coal-ash waste. It is costing Duke money to comply with that

statute, but the root cause of many of those expenses is Duke's earlier—and already unlawful—mishandling of its coal ash.

In 2017, Duke filed the rate cases at issue here, seeking to force consumers to pay almost all of the costs of cleaning up Duke's coal ash. In the short run, Duke sought to recover seven hundred million dollars from consumers. Over the long run, Duke estimates, its coal-ash clean-up costs will exceed five billion dollars.

The Attorney General and other parties intervened in Duke's rate proceedings. They presented evidence that Duke unreasonably managed its coal ash and that consumers should not be made to pay all of the costs that flowed from that mismanagement.

The Commission, however, held that consumers should pay all of the coal-ash costs that Duke asked for. It held that any groundwater pollution caused by Duke's management of its coal ash was reasonable, on the theory that polluting groundwater is illegal only when the pollution is not cleaned up. That holding was erroneous. If a polluter has to clean up pollution, that polluter has already broken the law.

The Commission also held that the intervenors did not present enough evidence to require Duke to prove that its coal-ash costs were reasonable.

That holding, too, was erroneous. The evidence of Duke's mismanagement here is extensive. It includes Duke's plea of guilty to criminal violations of the Clean Water Act. The evidence also includes repeated warnings, from Duke's own employees, that storing coal ash in unlined ponds created unacceptable risks of environmental harm.

Before the Commission, the intervenors' evidence was more than enough to require Duke to show that it had acted reasonably. That was a showing that Duke did not and cannot make.

Finally, the Commission also held that Duke was entitled to receive a return on its coal-ash expenditures. Under the law, a utility is entitled to receive a return on only those investments that it makes to provide service to current customers. That was not the case here. If the Commission's orders stood, they would allow Duke to receive a profit from cleaning up the very pollution that its own mismanagement caused.

In its only acknowledgment of Duke's illegal conduct, the Commission ordered a reduction of the profit it wrongly awarded Duke on its coal-ash expenses. It called this reduction in Duke's new profits a "management penalty." This "penalty" is a mirage—a deduction from something Duke never should have been awarded in the first place.

The Commission's errors call for the Court to reverse the orders that require Duke's ratepayers to bear Duke's imprudently incurred coal-ash expenses.

STATEMENT OF THE CASE

These two appeals involve orders that increased the rates of two utility companies owned by Duke Energy: Duke Energy Progress and Duke Energy Carolinas.[1]

The Commission has the exclusive authority to set rates for electricity that Duke sells to its retail customers. N.C. Gen. Stat. §§ 62-3(23), 62-32, 62-130(a), (d) (2017).

When a public utility like Duke seeks to raise its rates, it applies to the Commission to hold a general rate case. Id. § 62-134. During the case, the utility has the burden to show that higher rates are needed. Id. §§ 62-75, 62-134(c).

---

[1] This brief refers to Duke Energy Progress and Duke Energy Carolinas as Progress and Carolinas, respectively. It refers to Progress and Carolinas collectively as Duke.

A. Duke Defers Its Costs to Close Its Coal-Ash Basins and to Clean Up the Pollution They Caused, Asking for Recovery in Future Rate Cases.

Duke began incurring costs in 2015 to close its coal-ash basins and to address the pollution that its basins had caused. (Progress R pp 3-11, 14-29; Carolinas R pp 3-11, 14-29) Late in 2015, before the rate cases here were filed, Duke petitioned the Commission for approval to defer its coal-ash costs for consideration in future rate cases. (Progress R pp 14-38) Before seeking this approval, Duke had deferred these costs by entering them in a special asset account, hoping to recover them in future rate cases. (Progress R pp 7-11, 26-28)

Duke sought approval from the Commission for this practice because, under the ratemaking statute, utilities are usually not reimbursed dollar for dollar for their past expenses. Instead, they are usually compensated by charging rates that are set prospectively, based on the costs that utilities incur during a test period. See N.C. Gen. Stat. § 62-133. After the rate cases here were filed, the Commission allowed Duke to defer its coal-ash costs for possible recovery later. (Progress R pp 421-423, 497; Carolinas R pp 108-110, 846-47)

B. Duke Asks the Commission to Increase Its Rates.

In 2017, Progress and Carolinas filed applications for general rate increases. (Progress R p 108; Carolinas R p 112) The two cases moved forward on parallel tracks, separated by about three months.

The Attorney General intervened in both cases. (Progress R p 484; Carolinas R p 831) In rate cases like these, the Attorney General has the authority to intervene to represent the using and consuming public of the state. N.C. Gen. Stat. §§ 62-20, 114-2(8)(a). Other interested parties also intervened, including the Utilities Commission's Public Staff[2] and the Sierra Club.[3]

1. Progress asks the Commission to increase its rates.

Progress filed its application for a general rate case first. (Progress R pp 108-397) As part of its application, Progress sought to recover from

---

[2] The Public Staff intervenes on behalf of the using and consuming public in all Commission proceedings that affect utility rates or service. N.C. Gen. Stat. § 62-15(d)(3).

[3] The Fayetteville Public Works Commission intervened in the Progress rate case. (Progress R p 480) It has authorized the Attorney General to state that it supports the Attorney General's arguments in this brief.

ratepayers the coal-ash costs that it had deferred from 1 January 2015 to 31 August 2017. (Progress R p 115)

After Progress filed its application, the Commission opened a rate case under N.C. Gen. Stat. § 62-137. (Progress R p 398) The Commission then conducted an evidentiary hearing.

At the hearing, the Attorney General and other intervenors argued that Progress's recovery of its coal-ash costs should be eliminated or substantially limited. The Attorney General argued that Progress should not be able to recover these costs, because Progress had managed its coal ash unreasonably. (Progress R pp 630-34) Under the ratemaking statute, a utility may recover operating expenses from ratepayers only if the expenses are reasonably incurred. N.C. Gen. Stat. § 62-133(b)(3).

In addition, the Attorney General argued that Progress's investors should not be paid a return on—that is, allowed to profit from—Progress's closure of its coal-ash basins, because those costs were not spent on property that is used and useful for providing current electric service. (Progress R pp 633-34) Under the ratemaking statute, rates are set to give a utility the opportunity to receive a fair return on the reasonable cost of its property, but

only when that property is used and useful for providing current service. N.C. Gen. Stat. § 62-133(b)(1), (c).

Under Commission orders, Progress currently receives a 7.09% return on its used and useful property. (Progress R p 493) Carolinas receives a return of 7.35%. (Carolinas R p 838)

The Commission rejected the Attorney General's arguments and ordered that Progress should recover nearly all of its deferred coal-ash costs.[4] (Progress R pp 477-754) The Commission ordered that Progress's deferred costs would be amortized and gradually recovered from consumers in rates over five years. (Progress R p 706; Progress T 6 pp 307-10[5])

The Commission also awarded Progress a return each year on the unamortized balance of those costs that remained to be recovered.[6] (Progress R p 706)

---

[4] The Commission disallowed $9.5 million in costs that Progress agreed should be disallowed. (Progress R p 706)

[5] When this brief cites transcripts of the proceedings before the Commission, the citation includes the volume number of the transcript after the "T."

[6] The Commission also ruled that Progress may receive a deferred return on coal-ash costs that the Commission will consider in future rate cases.

In addition, the Commission imposed what it called a $30 million "management penalty": a $6 million reduction in Progress's return each year for five years. (Progress R pp 685, 706) Even after this penalty reduction, however, the Commission's orders still allow Progress to charge consumers over $232 million in coal-ash costs, plus an additional return of about $30 million on those costs.[7] (Progress R p 706; Progress Doc. Ex. 1378)

By allowing recovery, the Commission disagreed with the Attorney General's argument that Progress had incurred its coal-ash costs unreasonably. (Progress R pp 675-78) The Commission held that any pollution of groundwater that resulted from Duke's handling of its coal ash was reasonable, on the theory that polluting groundwater becomes illegal only when the pollution is not cleaned up. (Progress R p 661)

The Commission also held that the Attorney General and the other intervenors did not present enough evidence to require Progress to meet its

---

(Progress R p 685) It later ruled that Carolinas may also receive a similar return. (Carolinas R pp 1146-47)

[7] The above calculation of Progress's return includes the effects of compounding. The calculation is based on Progress's initial request to recover $241 million from its customers. After Progress conceded that it incurred certain costs unreasonably, the Commission disallowed some of Progress's costs, as noted above. See supra p 10 n. 4.

burden to prove that it had incurred its costs reasonably. (Progress R p 679) Finally, the Commission rejected the Attorney General's argument that Progress should not receive a return on its coal-ash costs. (Progress R p 706)

Commissioners Brown-Bland and Clodfelter both filed dissenting opinions. Each of them agreed that the Commission should not have allowed Progress to recover all of its requested coal-ash costs, because Progress incurred at least some of those costs unreasonably. (Progress R pp 711-23, 724, 726-54)

Commissioner Clodfelter also disagreed with the majority's decision to allow Progress to receive a return on its coal-ash costs. (Progress R pp 729, 750-54) He explained that the Commission's $30 million "penalty" is illusory: It is a mere deduction from a profit that Progress should not have received in the first place. (Progress R pp 750-54)

2. Carolinas asks the Commission to increase its rates.

After Progress sought higher rates, Carolinas also filed an application for a general rate case. (Carolinas R pp 112-342) Like Progress, Carolinas sought to recover the deferred coal-ash costs it had incurred between 1 January 2015 and 30 November 2017.[8] (Carolinas R p 123)

The Commission opened a separate rate case and held a separate evidentiary hearing for Carolinas. (Carolinas R pp 343-44) At the hearing, the Attorney General and other intervenors again argued that Carolinas' coal-ash costs should be substantially or entirely disallowed. The Attorney General also argued that Carolinas should not be allowed to receive a return on its coal-ash costs. (Carolinas R pp 1042-50)

After the hearing, the Commission entered an order that required Carolinas to reduce its rates to account for a recent federal tax cut.[9] (Carolinas R pp 825-1226)

---

[8] The Commission's final order allowed Duke to recover costs incurred between 1 January 2015 and 31 December 2017. (Carolinas R p 847)

[9] In late 2017, while the Carolinas rate case was pending, Congress passed the Tax Cuts and Jobs Act. (Carolinas R p 1002) The Act lowered the corporate tax rate. That rate cut, in turn, significantly lowered Carolinas' need for revenue from its ratepayers. (Carolinas R p 1002)

However, the Commission also ordered that Carolinas should recover all of its deferred coal-ash costs. As with Progress, the Commission ordered that Carolinas' deferred coal-ash costs, along with a return, would be recovered in rates over the course of five years. (Carolinas R p 847) The Commission also imposed a "management penalty" on Carolinas, reducing the return that the Commission awarded to Carolinas by $14 million each year for five years. (Carolinas R p 847) Even after the reduction, however, Carolinas will still recover $545.7 million from ratepayers for coal-ash costs. (Carolinas R p 847) In addition, Carolinas will receive a return of about $50 million on its coal-ash costs. (Carolinas Doc. Ex. 5376)

In granting recovery to Carolinas, the Commission relied on reasons similar to its reasons for granting recovery to Progress. It held that Carolinas had acted reasonably in managing its coal ash, again on the theory that polluting groundwater is illegal only when the pollution is not cleaned up. (Carolinas R p 1121) It also held that the intervenors had not offered enough evidence to require Carolinas to meet its burden to prove that its costs were reasonable. (Carolinas R pp 1089-90) Finally, the Commission again rejected the Attorney General's argument that Carolinas should not receive a return on its coal-ash costs. (Carolinas R pp 1092-94)

Commissioners Brown-Bland and Clodfelter again dissented from the Commission's order. As in Progress, both dissenting commissioners would have disallowed recovery for at least some of Carolinas' coal-ash costs. (Carolinas R pp 1159-1189)

Commissioner Clodfelter also dissented from the Commission's decision to allow Carolinas to receive a return. (Carolinas R pp 1190-1204) Awarding Carolinas a return, he pointed out, turned the disposal of coal ash into a profit-making opportunity for the company. (Carolinas R pp 1203-04)

The Attorney General and the Sierra Club appealed from the Progress order and from the Carolinas order. (Progress R pp 954-70; Carolinas R pp 1357-71, 1381-84) The Public Staff cross-appealed from both orders. (Progress R pp 971-79; Carolinas R pp 1398-1401) In both cases, the intervenors stated exceptions to the Commission's treatment of Duke's coal-ash costs.[10]

This Court then consolidated these two appeals.

---

[10] The North Carolina Justice Center and the North Carolina Sustainable Energy Association also appealed, on other grounds, from the Commission's order in the Carolinas case. (Carolinas R pp 1372-80)

STATEMENT OF THE GROUNDS FOR APPELLATE REVIEW

Because these appeals involve final orders of the Commission in general rate cases, this Court has direct appellate jurisdiction under N.C. Gen. Stat. § 7A-29(b).

STATEMENT OF THE FACTS

A. Duke Begins Storing Coal Ash in Unlined Basins.

The power industry, including Duke, has used coal to generate electrical power for decades. (See, e.g., Progress T 16 p 106) When coal is burned, it produces substantial quantities of waste, known variously as coal ash, coal-combustion residuals (CCRs), or coal-combustion products (CCPs). (Progress Doc. Ex. 815; Carolinas Doc. Ex. 781)

As Duke itself has acknowledged, "[c]oal ash contains various heavy metals and potentially hazardous constituents, including arsenic, barium, cadmium, chromium, lead, manganese, mercury, nitrates, sulfates, selenium, and thallium." (Progress Doc. Ex. 815; Carolinas Doc. Ex. 781)

Starting in the 1950s, Progress and Carolinas began using unlined basins to store the coal ash generated by their power plants. (See, e.g., Progress Doc. Ex. 509; Carolinas Doc. Ex. 2340) Progress and Carolinas

would mix coal ash with water to form a slurry, which they would then transfer to unlined basins through pipes. (Progress Doc. Ex. 815; Carolinas Doc. Ex. 781)

In these basins, the coal ash would separate from the slurry and would settle at the bottom of the basins, while less-contaminated water would rise to the surface. (Progress Doc. Ex. 815-16; Carolinas Doc. Ex. 781-82) Because the basins were not lined, the coal ash stored in the basins, along with heavy metals and other pollutants in the coal ash, began to contaminate the nearby groundwater. (Progress Doc. Ex. 815-16; Carolinas Doc. Ex. 781-82)

B. Duke Learns That Its Coal Ash Is Contaminating Groundwater, But Continues to Store Coal Ash in Unlined Basins.

In the late 1970s and 1980s, a growing consensus emerged among government and industry officials that storing coal ash in unlined basins contaminates groundwater.

For instance, in 1979, the Los Alamos Scientific Laboratory prepared a report that cautioned that "discarded wastes from coal combustion are a serious potential source of surface and ground water contamination." (Progress Doc. Ex. 2002; see also Carolinas Doc. Ex. 1414; Carolinas T 11 pp 244-45) The report warned that the "contaminated leachates and seepages

from disposal ponds" represented "the most significant environmental problem" facing the coal and utilities industries. (Progress Doc. Ex. 2003; Carolinas Doc. Ex. 1415)

A year later, in 1980, the Tennessee Valley Authority reached similar conclusions in a report that it prepared for the U.S. Environmental Protection Agency. In its report, the TVA said that one of the "most significant potential problems associated with ash disposal in ponds" is the "quantities of trace metals" that can leach from the ponds into groundwater. (Carolinas Doc. Ex. 6186) The TVA also pointed out that, under certain conditions, "ash deposited in the bottom of [an] ash pond may . . . leach [when] the ash is in contact with groundwater." (Carolinas Doc. Ex. 6190)

By 1988, these concerns had only grown. In that year, the EPA warned Congress that most "utility waste management facilities were not designed to provide a high level of protection against leaching." (Progress Doc. Ex. 694; Carolinas Doc. Ex. 6380; see Carolinas T 11 p 245) The EPA went on to warn that there was "potential for waste leachate [from ash ponds] to cause ground-water contamination." (Progress Doc. Ex. 694; Carolinas Doc. Ex. 6380; see Progress T 13 pp 181-83; Carolinas T 11 p 245)

In its 1988 report to Congress, the EPA noted a growing trend toward disposing of ash in on-site landfills instead of unlined basins. (Progress T 13 pp 182-83; Progress Doc. Ex. 722; Carolinas T 6 pp 35-36; Carolinas Doc. Ex. 6524) Indeed, as early as 1981, an industry report had noted that "the national trend is away from wet disposal systems toward dry handling methods." (Carolinas T 14 p 166; Carolinas Doc. Ex. 4180)

Here, before the Commission, one of Duke's witnesses testified that the personnel who managed coal ash for Progress and Carolinas likely would have been aware of reports, like these, that raised concerns about coal ash. (Progress T 16 pp 221-22; Carolinas T 14 pp 153-54, 164)

Despite these known risks and industry trends, Progress and Carolinas put ash in unlined basins throughout the 1980s and over the decades that followed. Progress and Carolinas did so even though they both knew that their ash basins were contaminating groundwater.

In 1996 and 1997, both Progress and Carolinas notified their insurers that they could face liability for violating the North Carolina law that prohibits groundwater contamination. Progress recognized that it could face environmental claims based on "the actual, alleged or threatened discharge . . . of pollutant[s]" from coal-ash basins at six of its coal-fired

plants. (Progress Doc. Ex. 273, 278) Carolinas reported that its coal-ash basins had contaminated that groundwater at levels "above the applicable state cleanup criteria" at all of the coal-fired plants where Carolinas had tested the groundwater. (Carolinas Doc. Ex. 600-02, 605, 609-11, 613)

The liability that Progress and Carolinas reported to their insurers stemmed from North Carolina's limits on groundwater pollution: the 2L rules. See 15A N.C. Admin. Code 2L.0101-.0515 (2018 & Supp. 2019); see also N.C. Gen. Stat. § 143-214.1 (directing the Environmental Management Commission to adopt the 2L rules). The 2L rules impose strict liability on any person whose activities cause the concentration of any substance in groundwater to exceed the limits set by the rules. 15A N.C. Admin. Code 2L.0103(d) (2018).

Progress and Carolinas held permits that allowed their ash basins to affect groundwater within a geographic "compliance boundary" that encircled those basins. (Carolinas Doc. Ex. 11748-14264) Contamination beyond that boundary and above the limits set by the rules, however, was illegal. See N.C. Gen. Stat. § 143-215.1(i); 15A N.C. Admin. Code 2L.0102(3), 2L.0107(a), (b).

Once Progress and Carolinas discovered actual or threatened violations of the 2L rules in 1996 and 1997, the rules required them to stop their basins from contaminating groundwater. Under the 2L rules, polluters that cause an exceedance—pollution above the limits stated in the rules—must, among other things, abate, contain, or control the migration of contaminants. 15A N.C. Admin. Code 2L.0106. The corrective action mandated by the rules can include the "eliminat[ion of] the source . . . of contamination" and the "removal, treatment or control of any primary pollution source." Id. r. 2L.0106(c)(2), (f)(3) (2015).[11]

Progress and Carolinas have not shown that, after they learned that they were violating the 2L rules (or were at least at serious risk of doing so), they took any action to control the exceedances or eliminate their source.

---

[11] Unless otherwise noted, the 2L rules cited in this brief are the rules in force today. The cited rules have been largely unchanged since 1989. See 15A N.C. Admin. Code 2L.0102(3), .0103(d), .0107(a), (b) (1989).

There is one exception: The corrective-action requirements in Rule 2L.0106, cited above, were amended after the enactment of the Coal Ash Management Act of 2014 (CAMA). See infra pp 25, 30-33. The version of Rule 2L.0106 that is cited above is the version in place before CAMA expressly mandated that Duke close its basins. That earlier version of Rule 2L.0106 was adopted in 1993. See 15A N.C. Admin. Code 2L.0106(c)(2), (f)(3) (1993).

(Progress T 21 p 170; Carolinas T 14 pp 258-59) All the record here shows is that Progress and Carolinas contacted their insurers.

Over the decade that followed, staff members at Progress and Carolinas repeatedly acknowledged that the unlined basins at the companies' power plants were contaminating groundwater. For instance:

- In 2003, Carolinas prepared a ten-year plan for managing its coal-ash waste—a plan that apparently was never implemented. In that plan, Carolinas recognized that its environmental modeling showed that "in order to avoid mercury, selenium, sulfate, and cadmium contamination," Carolinas needed to stop using unlined basins to store coal ash. Instead, Carolinas would have to install a landfill cap or explore other options for storing coal ash. (Carolinas Doc. Ex. 3690)
- In 2004, to plan for the future of the ash basins at Progress's Sutton power plant, Progress prepared a report. In that report, Progress acknowledged that a monitoring well near one of the basins at Sutton had shown high levels of arsenic. (Progress Doc. Ex. 1947) In that report, Progress also recognized that the basins at Sutton would have to be "emptied and placed in a lined

containment to eliminate the leaching of the ash products into the ground water system." (Progress Doc. Ex. 1947)

- In 2007, Carolinas again reexamined its coal-ash management practices. Carolinas noted that coal ash is associated with long-term environmental, legal, and financial risks. It stated that the riskiest form of coal-ash disposal is "disposal in surface impoundments." (Carolinas Doc. Ex. 3902, 3904) It concluded that "recent ash sampling has revealed that [coal-ash] leaching chemistry is 'worse' than previously assumed." (Carolinas Doc. Ex. 3933) Carolinas also recognized that it should move toward storing coal ash in landfills instead of unlined basins. (Carolinas Doc. Ex. 3936)

Thus, during the 2000s, Progress and Carolinas both knew that their ash basins were contaminating groundwater. Even so, they continued to put coal ash in unlined basins. They did not move toward safer methods of storing coal ash.

In 2012, Progress and Carolinas merged. (Progress Doc. Ex. 813; Carolinas Doc. Ex. 779)

Shortly after the merger, in 2013, the State of North Carolina and other plaintiffs sued to enjoin Duke from violating the 2L rules and other environmental statutes. In verified complaints, the State showed that 2L exceedances existed at all fourteen of Duke's coal-fired power plants in North Carolina. The State noted that it was still working to determine whether the exceedances at five of the power plants were naturally occurring. At nine power plants, however, the State showed that Duke's basins had caused violations of the 2L rules. (Progress Doc. Ex. 2032-2105; Carolinas Doc. Ex. 10646-86)

In 2013, after those lawsuits were filed, Duke acknowledged in internal reports that exceedances of the 2L standards existed "at all ash ponds" at its fourteen coal-fired plants. (Carolinas Doc. Ex. 11614; see Carolinas Doc. Ex. 11672-93) The following year, Duke's head of environmental-safety operations informed senior management that it was "very clear that our coal ash is impacting the groundwater at all locations." (Carolinas Doc. Ex. 679) He warned that Duke was falling behind its schedule to close retired ash ponds. He urged Duke to "[a]ggressively pursue" closure of ash ponds at all of its retired sites. (Carolinas Doc. Ex. 727; see Carolinas Doc. Ex. 744)

Before the State's 2013 lawsuits against Duke could reach judgment, however, in early 2014, a pipe under one of Duke's coal-ash basins at its Dan River plant failed. As a result, tens of thousands of tons of coal ash spilled into the Dan River over six days. (Progress Doc. Ex. 837; Carolinas Doc. Ex. 803) The spill coated the banks of the river with waste as far as sixty-two miles downstream. (Progress Doc. Ex. 837; Carolinas Doc. Ex. 803)

The Dan River spill led the General Assembly to enact the Coal Ash Management Act of 2014 (CAMA). See Act of Aug. 20, 2014, ch. 122, secs. 3(a)-3(f), 2014 N.C. Sess. Laws 828, 830-62 (codified at N.C. Gen. Stat. §§ 130A-309.200 to .231). The statute compelled Duke to address the illegal groundwater contamination that Duke failed to stop, and failed to remedy, for more than a decade.

C. Duke's Poor Maintenance of Its Coal-Ash Basins Culminates in the Dan River Spill.

The 2014 Dan River spill was not the result of an isolated episode of negligence.

As early as 1995 and 1996, safety inspections mandated by state law began to reveal that Progress's and Carolinas' coal-ash basins were falling into disrepair. The inspections revealed issues with, among other things, the erosion of the earthen dams that held back the basins, the growth of woody vegetation along the basins' earthen dams, and cracks in the basins' spillways and dikes. (Progress Doc. Ex. 3113-14; Carolinas Doc. Ex. 10064-68) Carolinas, in particular, was faulted for its failure to conduct annual inspections of its basins, to train its employees properly, and to monitor the stability of its basins' slopes. (Carolinas Doc. Ex. 10064-68)

Duke's neglect of its ash basins caused illegal discharges of polluted water from Duke's basins into neighboring rivers. Under the federal Clean Water Act, it is illegal to make unpermitted discharges of pollutants into waters that are subject to federal jurisdiction. See 33 U.S.C. §§ 1311(a), 1342 (2012 & Supp. V 2017). Here, Duke made multiple illegal discharges of pollutants into federally protected waters.

For instance, during a 2008 inspection of the ash basins at one of Progress's plants, inspectors noticed that two risers (vertical pipes that help control the basins' water level) would likely soon develop problems. (Progress Doc. Ex. 841; Carolinas Doc. Ex. 807) The inspectors recommended that Progress use boats to inspect the risers, but Progress failed to do so. (Progress Doc. Ex. 840, 842; Carolinas Doc. Ex. 806, 808) On one of the risers, Progress later failed to replace a skimmer that was designed to prevent discharges from the basin, despite being advised to do so after a 2012 inspection. (Progress Doc. Ex. 842-43; Carolinas Doc. Ex. 808-09)

By 2013, both risers in these basins were leaking. (Progress Doc. Ex. 843; Carolinas Doc. Ex. 809) Progress's failure to maintain the risers ultimately caused coal-ash wastewater to leak into the Cape Fear River for at least two years. (Progress Doc. Ex. 881; Carolinas Doc. Ex. 847)

Illegal discharges like these were not limited to Progress's plants. Duke's approach to maintaining its ash basins would eventually cause an environmental disaster at a plant operated by Carolinas: the Dan River plant.

At Dan River, under the plant's primary ash basin were two stormwater pipes: a 48-inch metal pipe that was installed in 1954, and a 36-

inch reinforced concrete pipe. (Progress Doc. Ex. 820-21; Carolinas Doc. Ex. 786-87)

In 2011, two Carolinas engineers recommended that Carolinas spend $20,000 to perform camera inspections of these pipes, because Carolinas did not know their condition. The engineers also warned that if the pipes failed, there would be environmental harm. (Progress Doc. Ex. 832-33; Carolinas Doc. Ex. 798-99) Carolinas denied this request in 2011. It denied it again in 2012. (Progress Doc. Ex. 833-34; Carolinas Doc. Ex. 799-800)

Two years later, in February 2014, a joint in the 48-inch metal pipe failed, causing about 39,000 tons of coal ash and 27 million gallons of contaminated water to flow into the Dan River. The pipe was sixty years old—well beyond its serviceable life. Ultimately, corrosion and the weight of the basin above the joint in the pipe caused the pipe to fail. (Progress Doc. Ex. 836; Carolinas Doc. Ex. 802) After the pipe failed, coal ash flowed down the Dan River for sixty-two miles over six days. (Progress Doc. Ex. 835-37; Carolinas Doc. Ex. 801-03)

After the spill, investigators discovered that wastewater had infiltrated the 36-inch concrete pipe. That pipe had been discharging arsenic-contaminated water into the Dan River for more than two years. (Progress

Doc. Ex. 838; Carolinas Doc. Ex. 804) During the year before the spill, Duke had ignored inspectors' recommendations to monitor the outflow of the 36-inch pipe to check for leaks. (Progress Doc. Ex. 827-30; Carolinas Doc. Ex. 793-96)

A year after the spill, in February 2015, Duke pleaded guilty to nine criminally negligent violations of the Clean Water Act at five of its plants, including Dan River. For all nine counts, Duke admitted that it had failed "to exercise the degree of care that someone of ordinary prudence would have exercised in the same circumstances." (Progress Doc. Ex. 2900; Carolinas Doc. Ex. 3971)

Duke's guilty plea covered more than the Dan River spill. It also covered Duke's illegal discharges, discussed above, into the Cape Fear River. The plea also covered other illegal discharges from channels that carried contaminated water from Duke's basins into the Neuse, Catawba, and French Broad Rivers for several years. (Progress Doc. Ex. 811-12; Carolinas Doc. Ex. 777-78)

D. North Carolina Responds to the Dan River Spill by Enacting CAMA.

In May 2014, three months after the Dan River spill, a group of state senators introduced the bill that eventually became CAMA. (Progress Doc. Ex. 3791-805; Carolinas Doc. Ex. 2164-78) In the bill's preamble, the drafters of the legislation explained that the impetus for CAMA was the State's need to respond to the spill of "an estimated 39,000 tons of coal ash . . . into the Dan River" from one of Duke's basins, as well as the State's need to "protect [its] surface water and groundwater." (Progress Doc. Ex. 3791; Carolinas Doc. Ex. 2164)

CAMA bans the construction of new coal-ash basins and the expansion of existing basins after October 2014. N.C. Gen. Stat. § 130A-309.210(a). The statute requires Duke to stop putting coal-ash slurry into active basins by the end of 2019. Id. § 130A-309.210(f). It also imposes deadlines for closing those basins. Id. § 130A-309.214.

The General Assembly specifically designated basins at four plants as high priorities for closure: the basins at the Dan River, Sutton, Asheville, and Riverbend plants. CAMA sec. 3(b), 2014 N.C. Sess. Laws at 860. By August 2019, Duke is required to close high-priority basins by draining their

water, excavating their coal ash, and then either putting the excavated ash in a landfill or putting it to legally permissible beneficial uses. Id. sec. 3(c)(1)-(2), 2014 N.C. Sess. Laws at 860-61.[12]

For the remainder of Duke's basins, the legislature has mandated that the Department of Environmental Quality (DEQ) designate these basins as intermediate- or low-risk, depending on certain statutory criteria. N.C. Gen. Stat. § 130A-309.213(d). For intermediate-risk basins, Duke has been given a closure deadline of December 2024. Id. § 130A-309.214(a)(1), (2). Duke is required to excavate the ash in those basins and then put the ash in a landfill or to beneficial use. Id.[13] For low-risk basins, Duke is required to close the basins by December 2029. Id. § 130A-309.214(a)(3).

Although CAMA directs Duke to close its unlined ash basins, these basins could have been closed under North Carolina law that predated CAMA. As noted above, the 2L rules can require polluters to "eliminate the

---

[12] The General Assembly later amended CAMA to allow the basins at the Asheville plant to be closed by 2022. See Act of June 20, 2015, ch. 110, sec. 2(a), 2015 N.C. Sess. Laws 241, 242.

[13] By statute, the legislature has designated the basins at three plants as intermediate-risk: the basins at the H.F. Lee, Cape Fear, and Weatherspoon plants. See Act of July 1, 2016, ch. 95, sec. 3(a), 2016 N.C. Sess. Laws 532, 558.

source . . . of contamination" and to remove "any primary pollution source" when these steps are necessary to stop groundwater contamination. 15A N.C. Admin. Code 2L.0106(c)(2), (f)(3). Thus, DEQ had the authority to require Duke to close its basins under the 2L rules themselves. Indeed, even before CAMA was enacted, Duke had already committed to close at least some of its basins by putting coal ash into lined landfills. (Progress Doc. Ex. 682-85)

CAMA also underscores preexisting law by directing Duke to prepare plans that show how Duke will "restor[e] groundwater in conformance with" the 2L rules—rules that predated CAMA. N.C. Gen. Stat. § 130A-309.211(b)(1). Under CAMA, Duke's corrective action on groundwater must follow these 2L-based plans. Id. § 130A-309.211(b)(2), (3).

In the meantime, while the legislature was enacting CAMA, the State's 2013 lawsuits that were filed before the Dan River spill—lawsuits that had sought to enjoin Duke from violating the 2L rules—remained pending. In 2016, at Duke's request, a trial court ruled on the State's claims about the basins at seven of the fourteen plants at issue. (Progress Doc. Ex. 3000-99; Carolinas Doc. Ex. 9963-10062) The court held that complying with CAMA, excavating and removing the contents of Duke's coal ash basins, and

implementing a corrective action plan approved by DEQ would remedy the violations of the 2L rules that the State's complaints had identified. (Progress Doc. Ex. 3000-37, 3058-86; Carolinas Doc. Ex. 9963-10000, 10021-49) As a result, the court granted partial summary judgment on the State's claims, requiring Duke to comply with CAMA.

In its order, the court also recognized that in the area around Duke's coal-ash basins, CAMA requires Duke to remedy any groundwater contamination that violates the 2L rules. (Progress Doc. Ex. 3011, 3017, 3024, 3030, 3067, 3073, 3078; Carolinas Doc. Ex. 9974, 9980, 9987, 9993, 10030, 10036, 10041) As of 2017, Duke's monitoring wells had recorded at least 5948 test results that showed violations of the 2L rules around its coal-ash basins. (Progress Doc. Ex. 1118-19; Progress T 18 pp 254-56, 284, T 19 pp 83-86; Carolinas Doc. Ex. 2043-45, Carolinas T 26 pp 646, 698-702)[14]

[14] Concern over the Dan River spill also prompted South Carolina environmental regulators to require Duke to take immediate action to clean up coal-ash waste in South Carolina. (See Carolinas T 24 pp 115-16, 152-54) Some of the costs at issue in this appeal resulted from Duke's clean-up efforts under consent orders with South Carolina regulators and/or federal regulators. (Progress R p 20; Carolinas R p 20)

E. Duke Starts to Close Its Coal-Ash Basins.

After CAMA was enacted in 2014, Duke began incurring costs to close its ash basins to comply with the legislation. Between 1 January 2015 and 31 December 2017, Duke spent over 750 million dollars on closing its basins. (Progress R p 497; Carolinas R p 847) At the time of the rate cases here, Duke estimated that its total costs to dispose of its coal-ash waste would exceed five billion dollars. (Progress Doc. Ex. 568; Carolinas Doc. Ex. 3576)

As noted above, CAMA requires Duke to close certain basins by putting ash in landfills or by putting ash to beneficial use. See N.C. Gen. Stat. § 130A-309.214(a)(1), (2). To meet this mandate, Duke has incurred operating expenses that include dewatering its basins, treating the contaminated water from the basins, excavating ash from the dewatered basins, and putting the excavated ash in landfills. (Progress Doc. Ex. 567; Carolinas Doc. Ex. 3642)

At certain plants, as noted above, Duke has also had to meet an accelerated closure deadline of August 2019. See CAMA sec. 3(b), 2014 N.C. Sess. Laws at 860. To meet this deadline, Duke has had to incur additional costs to haul away its coal ash, because Duke has not had enough time to build new landfills next to its basins. (Progress T 20 pp 37-40) For example,

at Progress's Sutton plant, to transport excavated ash to an off-site landfill, Progress had to build a new railway and contract with a third party to haul away the coal ash. (Progress T 18 pp 229-235) This work cost $80 million more than disposal in a new on-site landfill would have cost. (Progress T 18 pp 180, 304-05) Similarly, at the Dan River plant, Carolinas spent $70 million hauling ash to off-site landfills—hauling that cost three times more than on-site disposal would have cost. (Carolinas T 15 pp 20-21; Carolinas T 16 pp 20-21) Had Duke acted sooner to close its ash basins, these added costs could have been avoided.

Many of these costs have been incurred at plants that are no longer even providing electrical service to Duke's customers.

For Progress, only three of the eight power plants for which Progress is seeking cost recovery are still providing service. (Progress Doc. Ex. 508-09, 568)

For Carolinas, half of the power plants for which it is seeking recovery are retired. Even at Carolinas' operating power plants, moreover, certain ash basins have not been used since the 1970s and 1980s. (Carolinas Doc. Ex. 2338, 2340, 3642)

Finally, nearly all of the coal ash at issue in these rate cases was burned to generate power many years ago. (Progress Doc. Ex. 339, 509; Carolinas Doc. Ex. 2340) Thus, the costs that Duke seeks to recover in these rate cases are unrelated to the current provision of electrical service.

SUMMARY OF THE ARGUMENT

The Commission erred in two ways: It wrongly let Duke recover its coal-ash costs from consumers, then compounded that error by awarding Duke a return on those costs.

First, the Commission erred by requiring consumers to bear all the coal-ash costs that Duke requested. Utilities may recover only those costs that are reasonable. That was not the case here.

The costs incurred by a utility are presumed to be reasonable, but once intervenors present affirmative evidence that a utility's costs are unreasonable, the utility has the burden to prove that it is entitled to recover those costs.

Here, the Attorney General and the other intervenors came forward with affirmative evidence that Duke's costs were unreasonable. They showed that Duke unreasonably put coal ash into unlined basins that

contaminated groundwater in violation of the state's 2L groundwater rules. The intervenors also showed that Duke's unreasonable management of its coal-ash basins, including the basins that caused the Dan River spill, contributed to Duke's costs of complying with CAMA.

The Commission, however, disregarded the intervenors' evidence. That decision was erroneous for multiple reasons:

- First, the Commission erred by disregarding the evidence that Duke acted unreasonably by violating the state's 2L groundwater rules.
    - The Commission erred by reasoning that polluting groundwater is not illegal as long as pollution is eventually cleaned up. That holding was erroneous: The 2L rules forbid exceeding groundwater limits outside compliance boundaries even if the pollution is later cleaned up.
    - The Commission also erred by concluding that it lacks the authority to decide whether a utility has broken the law, even when the Commission considers whether the utility's costs are reasonable. This, too, was an error. The Commission has a statutory responsibility to decide

whether a utility's costs are reasonable. Illegal actions are not reasonable.

- The Commission also erred by holding that because the intervenors had not quantified the precise economic effect of Duke's unreasonable conduct, they had not done enough to require Duke to prove that its costs were reasonable. That holding held the intervenors to a standard that the law does not impose. Under this Court's decisions, to require Duke to meet its burden, the intervenors needed only to present affirmative evidence of unreasonable costs. Here, they presented ample evidence of that type.

The Commission's disregard of the intervenors' evidence was pivotal. Once the intervenors carried their initial burden, that showing activated Duke's burden to show the reasonableness of its costs.

Duke did not carry that burden. The Commission itself found that the evidence did not clearly show how Duke's unreasonable conduct affected its costs. Because Duke had the ultimate burden here, any uncertainty in the evidence should have led the Commission to disallow Duke's costs.

As a second major point, even if Duke could recover its coal-ash costs, the Commission erred by granting Duke a return on those costs. That return, which exceeds seven percent, allows Duke to receive a profit on cleaning up its own pollution.

To qualify under the ratemaking statute for a return, Duke's expenses had to be spent on property that is used and useful. Property is used and useful when it is employed to provide current service to a utility's customers.

Duke's coal-ash expenditures fail this test. Duke has spent money on dewatering coal ash, digging it out of the ground, and hauling it to a landfill. Those are waste-management expenses, not investments in facilities that provide current service to customers.

The coal ash at issue in these cases, moreover, was created when Duke burned coal to generate power years ago. Indeed, many of the basins and plants at issue in this case have been retired for years.

Despite these points, the Commission relied on three main arguments to support its decision to grant Duke a return on its coal-ash costs:

- It held that Duke could receive a return because accounting rules required Duke to create an entry that reflects its expected coal-ash liabilities.

- It also held that Duke could receive a return because the funds that Duke has spent on its coal-ash costs were provided by investors and therefore are property.
- Finally, the Commission held that it could award a return to Duke at its own discretion.

All three of those arguments suffer from the same fundamental error: They cannot overcome the statutory command that the Commission can grant a return only on property that is used and useful for providing current service.

Because Duke had no right to receive a return on its costs, the "penalty" that the Commission imposed—a mere reduction of an erroneously awarded return—was no penalty at all. It simply reduced the windfall profits that Duke can now receive by cleaning up the very pollution for which it is responsible.

Because the Commission erred by allowing Duke to recover its coal-ash costs and to receive a return on those costs, the Commission's orders should be reversed and Duke's costs disallowed.

ARGUMENT

Standard of Review

This Court reviews the Commission's decisions to determine whether they 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); see also State ex rel. Utils. Comm'n v. Pub. Staff-N.C. Utils. Comm'n, 322 N.C. 689, 698, 370 S.E.2d 567, 573 (1988) (reviewing decision under section 62-94).

The Commission's conclusions of law are reviewed de novo. State ex rel. Utils. Comm'n v. N.C. Waste Awareness & Reduction Network, 805 S.E.2d 712, 714 (N.C. Ct. App. 2017), aff'd per curiam, 812 S.E.2d 804 (N.C. 2018). Its findings of fact are reviewed to determine whether they are

supported by "competent, material and substantial evidence." State ex rel. Utils. Comm'n v. Cooper, 367 N.C. 444, 448, 761 S.E.2d 640, 643 (2014).

Separately, the Commission's decisions will also be reversed as arbitrary or capricious if they "fail to display a reasoned judgment." State ex rel. Utils. Comm'n v. Piedmont Nat. Gas Co., 346 N.C. 558, 573, 488 S.E.2d 591, 601 (1997).

Discussion of Law

The Commission erred in its treatment of Duke's coal-ash costs.

The ratemaking statute requires the Commission to set a utility's rates by calculating a formula that turns on the utility's "rate base" and "reasonable operating expenses." State ex rel. Utils. Comm'n v. Thornburg, 325 N.C. 463, 467 n.2, 385 S.E.2d 451, 453 n.2 (1989) [Thornburg I].

A utility's rate base consists of "the reasonable cost of the utility's property which is used and useful," minus depreciation. Id. Property is used and useful when it is employed to "provid[e] service to the public." Id.

Operating expenses "include costs for fuel, wages and salaries, and maintenance, as well as annual depreciation charges and taxes." Id.

To be recovered in rates, operating expenses must be reasonable. N.C. Gen. Stat. § 62-133(b)(3). This reasonableness standard applies because, in its absence, monopoly utilities like Duke could pass on "exorbitant charges" to consumers. State ex rel. Utils. Comm'n v. Gen. Tel. Co., 281 N.C. 318, 335, 189 S.E.2d 705, 717 (1972).

To determine the rates that a utility may charge, the Commission begins by calculating the above figures. It then multiplies the utility's rate base by a rate of return that will grant the utility "a fair return on [its] capital investment." Thornburg I, 325 N.C. at 467 n.2, 385 S.E.2d at 453 n.2. The Commission then adds that product to the utility's operating expenses. That sum represents the revenue that a utility may recover through its rates. Id.

Here, when the Commission set rates to account for Duke's coal-ash costs, it erred in two major ways:

- First, it erroneously allowed Duke to recover its coal-ash costs from consumers, even though Duke did not show that these operating expenses were reasonably incurred.
- Second, it wrongly awarded Duke a profit on these expenses, even though these expenses were not spent on property that is used and useful.

Because of those errors, the Commission's orders should be reversed.

I. DUKE DID NOT SHOW THAT IT INCURRED ITS COAL-ASH COSTS REASONABLY.

The Commission erred by allowing Duke to recover its coal-ash costs, because Duke did not prove that its costs were reasonably incurred.

As noted above, under section 62-133(b)(3), utilities may ask their consumers to bear the cost of only those operating expenses that are reasonable.

Under the ratemaking statute, utilities have the burden to show that their costs were reasonably incurred. N.C. Gen. Stat. §§ 62-75, 62-134(c). A utility's costs "are presumed to be reasonable unless challenged." State ex rel. Utils. Comm'n v. Conservation Council, 312 N.C. 59, 64, 320 S.E.2d 679, 683 (1984). To make a utility satisfy its burden, intervenors must offer "affirmative evidence . . . that challenges the reasonableness of [the utility's] expenses." State ex rel. Utils. Comm'n v. Intervenor Residents, 305 N.C. 62, 76, 286 S.E.2d 770, 779 (1982) [Bent Creek]. Once intervenors make this showing, however, the utility must prove that its costs were reasonably incurred. Id.

This Court has held that costs are not reasonably incurred when they stem from a utility's violation of environmental laws. State ex rel. Utils. Comm'n v. Pub. Staff, N.C. Utils. Comm'n, 317 N.C. 26, 40-41, 343 S.E.2d 898, 907-08 (1986) [Glendale Water]. Here, before the Commission, the Attorney General and the other intervenors cited this point of law.

The intervenors also presented affirmative evidence: Duke's admissions of criminal negligence, groundwater testing results from Duke's monitoring wells that showed violations of state law, and other evidence that challenged the reasonableness of Duke's coal-ash costs.

Despite this evidence, the Commission concluded that the intervenors did not adequately challenge Duke's costs, so Duke did not need to prove that its costs were reasonable. As shown below, that conclusion was erroneous. See infra pp 52-63.

The error, moreover, was pivotal. Because the Commission erroneously concluded that the intervenors did not carry their initial burden, it presumed that Duke's coal-ash costs were reasonably incurred. Without the benefit of that presumption, Duke would have failed to satisfy its burden: As the Commission itself found, the evidence did not clearly establish that

Duke's costs were reasonable. Duke's costs therefore should have been disallowed. See infra pp 63-66.

Finally, as shown below, the penalty that the Commission imposed on Duke was not an adequate substitute for disallowing Duke's costs. See infra pp 66-68.

A. The Commission Erred by Holding That the Intervenors Did Not Adequately Challenge the Reasonableness of Duke's Coal-Ash Costs.

The Attorney General and the other intervenors adequately challenged Duke's coal-ash costs by presenting affirmative evidence that these costs were unreasonable.

The intervenors challenged the reasonableness of Duke's costs in two ways. First, they showed that Duke unreasonably incurred costs when it decided to put coal ash in unlined basins that illegally contaminated this state's groundwater. Second, they also showed that Duke's unreasonable management of its basins resulted in the enactment of CAMA, which imposed additional costs on Duke.

As shown below, the Commission erred by holding that this showing was not enough to require Duke to prove that its costs were reasonable.

1. The intervenors showed that Duke unreasonably polluted groundwater by putting coal ash in unlined basins.

As this Court has held, a utility's expenses that result from imprudent management are unreasonable. See State ex rel. Utils. Comm'n v. N.C. Power, 338 N.C. 412, 421, 450 S.E.2d 896, 901 (1994). One important type of imprudent management is mismanagement that results in environmental violations. See Glendale Water, 317 N.C. at 40-41, 343 S.E.2d at 907-08.

That principle applies here. As the intervenors showed before the Commission, Duke unreasonably polluted this state's groundwater and violated the 2L rules by putting coal ash in unlined basins.

Specifically, the intervenors showed that Duke has known for decades that its coal-ash basins were polluting groundwater in violation of the 2L rules, or at least that the basins would eventually do so. For example, as noted above:

- Since at least the late 1970s and early 1980s, it has been well known that storing coal ash in unlined basins contaminates groundwater. (Progress Doc. Ex. 694, 722, 2002-03; Progress T 13 pp 181-83; Carolinas Doc. Ex. 1414-15, 4180, 6186-90, 6380, 6524; Carolinas T 6 pp 35-36, T 11 pp 244-45, T 14 p 166)

- In 1996 and 1997, Progress and Carolinas both recognized that they were either violating the 2L rules or faced a serious risk of doing so. As a result, they notified their insurers that they faced liability for violating the 2L rules. Carolinas stated that pollution existed at levels "above the applicable state cleanup criteria" at all of its plants where it had tested the groundwater. (Carolinas Doc. Ex. 600, 601, 602, 610, 611; see also Progress Doc. Ex. 273, 278)
- In 2003, Carolinas acknowledged that its use of unlined coal-ash basins was causing "mercury, selenium, sulfate, and cadmium contamination" around the basins. (Carolinas Doc. Ex. 3690)
- In 2004, Progress similarly recognized that the basins at its Sutton plant were leaching "ash products into the ground water system." (Progress Doc. Ex. 1947)

Over the years that followed, Duke failed to act to stop its basins from contaminating groundwater. Unsurprisingly, that failure has resulted in widespread violations of the 2L rules. As explained above, by 2017, once a comprehensive system of monitoring wells had been installed around Duke's

basins, the wells recorded nearly 6000 test results that showed violations of 2L rules. (Progress Doc. Ex. 1118-19; Progress T 18 pp 254-56, 284; Progress T 19 pp 83-86; Carolinas Doc. Ex. 2043-45; Carolinas T 26 pp 646, 698-702)

Duke could have prevented these violations. It has known for years how to stop its ash from contaminating groundwater: putting the ash in lined landfills, as opposed to unlined ponds. For example, in 2004, staff members at Progress recognized that the ash at the Sutton plant would have to be "placed in a lined containment." (Progress Doc. Ex. 1947) Similarly, in 2007, staff members at Carolinas acknowledged that the company should "encourage use of landfills as [the] primary disposal option" for coal ash. (Carolinas Doc. Ex. 3936)

By not acting on these insights in a timely way, Duke incurred costs that it could have avoided. For example, if Duke had built lined landfills or converted to dry-ash handling sooner, it would not have had to pay to excavate ash that it could have already put in lined landfills years earlier. (Carolinas T 15 pp 22-23; Carolinas Doc. Ex. 3908-09) Commissioner Brown-Bland recognized this point in her dissenting opinion below. (Progress R pp 721-22)

Likewise, if Duke had built lined landfills at its plants sooner, it could have avoided the cost of transporting ash to off-site landfills. Because of Duke's delay in building lined landfills, it has incurred transport costs to meet CAMA's deadlines for closing coal-ash basins. Both dissenting commissioners recognized this point. (Progress R pp 721, 737-40)

In sum, the intervenors showed that Duke acted unreasonably by continuing to put ash into unlined basins after Duke knew that doing so would violate the law by contaminating groundwater.

2. The intervenors showed that Duke unreasonably managed its unlined basins.

The intervenors also showed that Duke unreasonably managed its unlined basins—mismanagement that eventually resulted in the spill at Duke's Dan River plant. As noted above:

- As early as the 1990s, inspections of Carolinas and Progress's basins showed that they were falling into disrepair. (Progress Doc. Ex. 3113-14; Carolinas Doc. Ex. 10064-68)
- When problems with the basins began to emerge, Duke failed to inspect and repair them adequately. For instance, Duke did not adequately inspect and repair the risers for the basins at its Cape

Fear plant, causing contaminated water to leak into the Cape Fear River. (Progress Doc. Ex. 840-43, 881; Carolinas Doc. Ex. 806-09, 847)

- This pattern of neglect culminated in the spill at Duke's Dan River plant, during which tens of thousands of tons of coal ash escaped into the Dan River. In the wake of the Dan River spill and discharges of pollutants from Duke's basins into other surface waters, Duke pleaded guilty to nine criminal violations of the Clean Water Act, involving five of its plants. (Progress Doc. Ex. 827-38, 2900; Carolinas Doc. Ex. 793-804, 3971)

Before the Commission, the intervenors showed that this series of events resulted in the passage of CAMA. As the Commission itself found, the General Assembly enacted CAMA in response to the spill of "an estimated 39,000 tons of coal ash . . . into the Dan River." (Progress Doc. Ex. 3791; Carolinas Doc. Ex. 2164; see also Progress R pp 682-83; Carolinas R pp 1143-44) In short, Duke's management of its ash basins was so unreasonable that the legislature was forced to intervene to address the problems created by Duke's admitted criminality.

CAMA caused Duke to incur costs that it would not otherwise have incurred, such as the cost of complying with CAMA's basin-closure deadlines. (See Progress R pp 683; Progress T 15 pp 50-55; Progress Doc. Ex. 2865-68; Carolinas R pp 1144; Carolinas T 11 pp 248-52; Carolinas Doc. Ex. 9952-58)

By presenting evidence of Duke's environmental violations, Duke's criminal convictions, and the events that followed from them, the intervenors presented "affirmative evidence" that challenged "the reasonableness of [Duke's] expenses." Bent Creek, 305 N.C. at 76, 286 S.E.2d at 779. This showing was more than enough to require Duke to prove that it incurred its coal-ash costs reasonably.

B. The Commission Erred by Concluding That Duke Managed Its Coal Ash Reasonably.

Despite the intervenors' showing, the Commission did not require Duke to prove that it incurred its coal-ash costs reasonably. As shown below, that failure was erroneous.

1. The Commission erroneously concluded that Duke's illegal contamination of groundwater was reasonable.

The Commission first erred by rejecting the intervenors' evidence that Duke violated this state's environmental laws.

The intervenors showed that Duke contaminated the groundwater around its basins in violation of the 2L rules. For instance, they showed that, as of 2017, nearly 6000 test results showed violations of the 2L rules around Duke's basins. (Progress Doc. Ex. 1118-19; Progress T 18 pp 254-56, 284, T 19 pp 83-86; Carolinas Doc. Ex. 2043-45, Carolinas T 26 pp 646, 698-702) As this Court has held, breaking environmental laws is unreasonable. Glendale Water, 317 N.C. at 40-41, 343 S.E.2d at 907-08.

Despite this Court's teachings, the Commission rejected the evidence that Duke violated North Carolina's environmental laws. To justify that rejection, the Commission cited two reasons, both of which were mistaken.

- First, it concluded that it is legal under the 2L rules to pollute groundwater, as long as the pollution is eventually cleaned up. (Progress R pp 660-61; Carolinas R pp 1121-23)
- Second, the Commission held that it lacks authority to assess independently whether a utility has acted unreasonably by

breaking the law. (Progress R pp 658-59; Carolinas R pp 1118, 1124-25)

As shown below, both of those legal conclusions were erroneous.

a. The Commission erred by concluding that polluting groundwater is illegal only when pollution is not cleaned up.

First, the Commission was wrong to hold that polluting groundwater becomes illegal only when pollution is not cleaned up.

In both rate cases, the Commission accepted testimony from a Duke witness who opined that "the existence of groundwater exceedances at or beyond the compliance boundaries" of Duke's ash basins does not show that Duke violated the 2L rules. (Progress R p 653; Carolinas R p 1121) Based on that testimony, the Commission held that even "when an exceedance requires corrective action," the exceedance is not proof of illegality. (Progress R p 661; Carolinas R p 1122) The Commission instead held that the 2L rules are violated only when a polluter fails to clean up contaminated groundwater. (Progress R p 661; Carolinas R pp 1122-23)

That reasoning was erroneous.

Cleaning up pollution does not negate the violation of the 2L rules that occurs when a polluter causes exceedances outside compliance boundaries. Instead, the 2L rules provide that "[n]o person shall conduct . . . any activity which causes the concentration of any substance" in groundwater to exceed the 2L standards. 15A N.C. Admin. Code 2L.0103(d) (emphasis added).[15]

Thus, cleaning up pollution does not show compliance with the law; it shows the opposite. After all, as this Court has recognized, cleaning up pollution under the 2L rules is necessary only when "groundwater quality has been degraded" in violation of the law. Cape Fear River Watch v. N.C. Envtl. Mgmt. Comm'n, 368 N.C. 92, 94, 772 S.E.2d 445 (2015) (emphasis added) (quoting 15A N.C. Admin. Code 2L.0106(a)). Similarly, a federal court has held that the 2L rules are "strict liability regulations" that "prohibit any activity" that causes "a concentration of [a] substance above the state's groundwater limits." Rudd v. Electrolux Corp., 982 F. Supp. 355, 365 (M.D.N.C. 1997) (emphasis added).

---

[15] Duke's basins were allowed to cause exceedances of groundwater standards within the basins' geographic compliance boundaries. Beyond those boundaries, however, exceedances are illegal unless they are naturally occurring. See 15A N.C. Admin. Code 2L.0102(3), .0107(a), (b).

Thus, the Commission erred when it held that Duke does not violate the 2L rules as long as it cleans up its pollution. Because of this error of law, the Commission wrongly ignored the intervenors' evidence that Duke acted unreasonably by breaking the law. See Glendale Water, 317 N.C. at 40-41, 343 S.E.2d at 907-08.

b. The Commission erroneously abdicated its duty to assess whether illegal conduct is unreasonable.

The Commission also erred by holding that that it lacked the authority—even when deciding whether Duke's costs were reasonable—to assess whether Duke had broken the law. (Progress R pp 658-59; Carolinas R pp 1118, 1124-25) In effect, the Commission held that a utility may reasonably break the law, as long as the utility does not admit wrongdoing and has not yet incurred an express finding of liability by a court. (Progress R pp 658-59, 663; Carolinas R pp 1118, 1124-25)

That reasoning, too, was erroneous.

The Commission has the statutory duty to determine whether a utility's costs are reasonable. N.C. Gen. Stat. § 62-133(b)(3). Here, to make that determination, the Commission had to assess whether Duke had incurred costs by breaking the State's environmental laws. See Glendale

Water, 317 N.C. at 40-41, 343 S.E.2d at 907-08 (holding that costs incurred because of violations of environmental laws are unreasonable).

This Court has held that the Commission may not abdicate its statutory duty to determine whether a utility has satisfied the requirements of the ratemaking statute. Instead, the Commission must "make[ ] its own independent conclusion supported by substantial evidence" on whether proposed rates are reasonable. State ex rel. Utils. Comm'n v. Carolina Util. Customers Ass'n, 348 N.C. 452, 466, 500 S.E.2d 693, 703 (1998) (quoting State ex rel. Utils. Comm'n v. State, 239 N.C. 333, 344, 80 S.E.2d 133, 141 (1954)) (internal quotation marks omitted).[16]

Thus, when the Commission assessed Duke's reasonableness here, it should not have deferred to Duke's refusal to admit wrongdoing, or to the fact that no court has yet held expressly that Duke violated the 2L rules. Instead, it should have assessed Duke's reasonableness based on all of the

---

[16] See also N.C. Power, 338 N.C. at 419-22, 338 S.E.2d at 900-02 (holding that the Commission must decide whether utilities' costs were reasonable); State ex rel. Utils. Comm'n v. Carolina Water Serv., 335 N.C. 493, 503, 439 S.E.2d 127, 132 (1994) (holding that "the Commission cannot simply substitute the . . . criteria of another agency as a substitute for its own determination"); State ex rel. Utils. Comm'n v. Edmisten, 291 N.C. 451, 464, 232 S.E.2d 184, 191-92 (1977) (holding that in setting rates, the Commission should not defer to accounting treatment adopted by utility).

"relevant, material and competent evidence" before the Commission. N.C. Gen. Stat. § 62-133(c).

The facts of these cases show vividly why the Commission's overly narrow reasonableness analysis is erroneous.

In 2013, the State sued to enjoin Duke's violations of the 2L rules. (Progress Doc. Ex. 2032-105; Carolinas Doc. Ex. 10646-86) Before the State's 2013 lawsuits reached judgment, however, the Dan River spill occurred. In response to the spill, to stop Duke from further polluting the waters of this state, the legislature enacted CAMA. CAMA secs. 3(a)-3(f), 2014 N.C. Sess. Laws at 830-62.

After CAMA was enacted, a trial court, at Duke's request, granted partial summary judgment on the State's claims. The court stated that Duke's compliance with CAMA (along with certain additional measures by Duke) had already largely granted the State the relief it sought in its complaints: stopping Duke from polluting the state's groundwater. (Progress Doc. Ex. 3006, 3064; Carolinas Doc. Ex. 9969, 10027)

As these events show, CAMA made it unnecessary for the court in the 2013 case to decide whether Duke violated the 2L rules, as long as Duke complies with CAMA and DEQ's implementation of CAMA. But CAMA was

a response to Duke's unreasonable management of its coal-ash basins. (Progress R pp 681-83; Carolinas R pp 1143-44) In light of these realities, it was especially improper for the Commission to conclude that Duke acted reasonably just because Duke had not yet been held expressly liable for violating the 2L rules. Duke's own mismanagement of its coal ash is what stopped a court from deciding that liability.

In sum, the Commission erred in its analysis of the reasonableness of Duke's conduct. Contaminating groundwater in violation of the 2L rules is illegal. The Commission, moreover, had the duty to judge for itself whether Duke violated those rules. By sidestepping that duty, the Commission erroneously disregarded the intervenors' showing that Duke acted unreasonably by polluting groundwater.

2. The Commission erroneously failed to require Duke to prove that its costs were reasonable, even though it agreed that Duke unreasonably managed its basins.

The Commission also erred in its treatment of the intervenors' evidence that Duke incurred added costs because it managed its basins unreasonably. The Commission agreed that Duke incurred added costs because of its unreasonable management of its basins. Even so, the

Commission wrongly failed to require Duke to prove that its costs were reasonable.

In its orders, the Commission agreed with the intervenors that Duke had managed its ash basins unreasonably. Specifically, the Commission agreed that Duke's mismanagement of the ash basins at its Dan River plant contributed to the enactment of CAMA—an event that, the Commission held, "resulted in increased costs" for Duke. (Progress R p 683; Carolinas R p 1144)

Despite agreeing that Duke had incurred unreasonable costs, however, the Commission nevertheless concluded that it could not disallow any of those costs. The Commission reached this conclusion by holding that the intervenors had not done enough to force Duke to prove that it had incurred its coal-ash costs reasonably. Specifically, the Commission held that the intervenors did not quantify the precise effect of Duke's unreasonable management of its ash basins. (Progress R p 675; Carolinas R pp 1086-87, 1093-96)

According to the Commission, to require utilities to meet their burden, intervenors must first (1) identify specific and discrete instances of imprudence by a utility, (2) identify prudent alternatives to the utility's

actions, and (3) quantify the precise economic effect of the utility's imprudence. (Progress R p 675; Carolinas R pp 1082-83) The Commission reasoned that this test flowed from this Court's decision in State ex rel. Utilities Commission v. Thornburg, 325 N.C. 484, 385 S.E.2d 463 (1989) [Thornburg II].

Neither Thornburg II nor the ratemaking statute, however, required the intervenors to make the heightened showing that the Commission demanded.

As noted above, under sections 62-134(c) and 62-75, utilities bear the burden to show that their costs are reasonable. As Bent Creek describes, all that is necessary to make a utility satisfy this burden is "affirmative evidence" that the utility's costs are unreasonable. 305 N.C. at 76, 286 S.E.2d at 779.[17]

[17] The General Assembly's decision in sections 62-134(c) and 62-75 to put the burden on utilities like Duke is consistent with the general principles that guide the allocation of litigation burdens. In litigation, "the party who asserts the affirmative" or "the party with peculiar knowledge of the facts" generally bears the burden of proof. Peace v. Emp't Sec. Comm'n, 349 N.C. 315, 328, 507 S.E.2d 272, 281 (1998). Where, as here, a utility seeks a rate increase under section 62-134, the utility is both the party that seeks affirmative relief and also the party that has the most knowledge about its costs and historical practices.

Thornburg II does not hold otherwise. In Thornburg II, this Court heard an appeal from a Commission order that decided whether a utility had incurred certain costs reasonably and prudently. 325 N.C. at 487-89, 385 S.E.2d at 465. In the proceedings before the Commission, the utility and the Public Staff both agreed that the prudence of the utility's costs should be scrutinized by an independent auditor. They also agreed that the auditor should assess prudence by applying a three-part test similar to the one that the Commission adopted here. Carolina Power & Light Co., No. E-2, Subs 537, 333, slip op. at 14-15, 94 P.U.R. 4th 353, 368 (N.C. Utils. Comm'n Aug. 5, 1988).

But the Commission never held that the stipulated three-part test for this audit would also decide whether future intervenors have satisfied their burden to present affirmative evidence. The Commission's only statement about burdens was that the utility bore "the burden of proving the prudence of its expenditures." Id. at 15.

The same was true in this Court. On appeal in Thornburg II, no party even challenged whether the intervenors before the Commission had done enough to require the utility to prove the reasonableness of its costs. Instead, an intervenor simply challenged the merits of the Commission's

prudence decision. It was in that limited context that this Court held that the evidence supported the Commission's decision. Thornburg II, 325 N.C. at 491-93, 385 S.E.2d at 467-68. The three-part test that the Commission relied on here does not appear anywhere in this Court's opinion. See id. at 484-500, 385 S.E.2d at 463-71.

Thus, Thornburg II does nothing to disturb this Court's earlier holding that, to activate a utility's burden, an intervenor need only present "affirmative evidence" of unreasonable costs. Bent Creek, 305 N.C. at 76, 286 S.E.2d at 779. Under Bent Creek, the intervenors here did enough to require Duke to prove that it incurred its coal-ash costs reasonably.

C. The Commission Erred by Not Disallowing Duke's Coal-Ash Costs.

As shown above, the intervenors did enough to require Duke to meet its burden. That burden should have resulted in the disallowance of Duke's coal-ash costs. After all, the Commission found that the evidence before it on the reasonableness of Duke's costs was inconclusive. (Progress R pp 679, 683; Carolinas R pp 1137, 1144-45) That inconclusiveness means that Duke did not meet its burden to show that its costs were reasonable.

As noted above, the Commission agreed with the intervenors that Duke was responsible for the Dan River spill. It also agreed that, because of the spill, Duke was responsible for "CAMA provisions that resulted in increased costs." (Progress R p 683; Carolinas R pp 1144-45)

The Commission, however, found that the evidence was inconclusive on how much Duke's unreasonable management of its basins affected Duke's coal-ash costs. (Progress R p 679; Carolinas R p 1137) It found that it could not precisely "identify and quantify" how many of Duke's costs were unreasonable. (Progress R p 683; Carolinas R pp 1144-45)[18]

---

[18] In the Carolinas case, after the intervenors protested that the Commission had misapplied the burden in the Progress case, the Commission held that Duke had not only satisfied its "prima facie burden of production," but also had met its "ultimate burden of persuasion" to show that its costs were reasonably incurred. (Carolinas R pp 1090-93; see also Carolinas R p 1136)

That holding is flatly inconsistent with the Commission's statement that it could not determine how much Duke's unreasonable management of its basins had increased Duke's costs. (Carolinas R pp 1137, 1139, 1144-45)

If this self-contradictory analysis really was the Commission's holding, such a holding is arbitrary and capricious. See N.C. Gen. Stat. § 62-94(b)(6); Piedmont Natural Gas, 346 N.C. at 573, 488 S.E.2d at 601 (holding that decisions are arbitrary and capricious when they fail to display a reasoned judgment).

That finding means that the Commission erred by not disallowing Duke's coal-ash costs.

Because Duke bore the burden, it also bore the risk of non-persuasion if the evidence on the reasonableness of its costs was inconclusive, as the Commission found was the case here. "The absence of . . . evidence in the record does not benefit Duke, for the burden is upon Duke to establish the reasonableness of the rate increases it has proposed." State ex rel. Utils. Comm'n v. Duke Power Co., 285 N.C. 377, 389, 206 S.E.2d 269, 277-78 (1974). Here, the Commission erred by not holding Duke to this burden.

Enforcing this burden makes perfect sense. When Duke seeks rate increases, it bears the burden of persuasion, because it is the party that has "knowledge of the facts." Peace, 349 N.C. at 328, 507 S.E.2d at 281.

Duke's access to information, and the duties conveyed by that knowledge, were in sharp relief here. If the record before the Commission had gaps, those gaps resulted from Duke's own decisions on what evidence to present. Before the Commission, Duke mostly limited its evidence to how Duke managed coal ash after the Dan River spill in 2014. (Progress R pp 730-31; Carolinas R pp 1160-62) Thus, if the record is spotty on how Duke's

conduct before 2014 affected its current costs, Duke itself is responsible for that gap in the evidence.

In the end, this issue comes down to a straightforward principle: When the "evidence [is] of insufficient probative force" to support a rate increase, the rate increase should be denied. State ex rel. Utils. Comm'n v. Motor Carriers' Traffic Ass'n, 16 N.C. App. 515, 520, 192 S.E.2d 580, 583 (1972).

Under that principle, the Commission's orders should be reversed and Duke's coal-ash costs disallowed.[19]

D. The Commission's Penalty Was Not a Substitute for Disallowing Duke's Coal-Ash Costs.

Finally, the penalty that the Commission imposed on Duke was not an adequate substitute for disallowing Duke's costs.

Instead of responding to Duke's mismanagement by disallowing Duke's costs, the Commission penalized Duke by reducing its return. The

---

[19] Alternatively, if this Court decided that total disallowance of Duke's costs is inappropriate, at a minimum, it could remand these cases to the Commission for a review of the evidence and a determination of which specific costs should be disallowed. That approach, which Commissioners Brown-Bland and Clodfelter took in their dissents (Progress R pp 720-22, 730-32; Carolinas R pp 1162-63, 1226), would allow the Commission to reconsider the appropriate allocation of Duke's coal-ash costs between consumers and Duke's shareholders.

Commission reduced Progress's return by $30 million, and it reduced Carolinas' return by $70 million. (Progress R pp 685, 706; Carolinas R pp 847, 1146)

Under section 62-133(b)(4) and this Court's decision in General Telephone, the Commission has the authority to penalize a utility by reducing its return when the utility is not soundly managed. N.C. Gen. Stat. § 62-133(b)(4); State ex rel. Utils. Comm'n v. Gen. Tel. Co., 285 N.C. 671, 680-81, 208 S.E.2d 681, 687 (1974).

That authority, however, is distinct from the Commission's duty under section 62-133(b)(3) to protect consumers by disallowing costs that are not reasonable. Because these two remedies are distinct, penalizing a utility under section 62-133(b)(4) by reducing its return cannot substitute for determining the reasonableness of a utility's costs. Indeed, in General Telephone, this Court recognized that a utility's misconduct can serve as a basis both for penalizing the utility and for separately reducing rates on other statutory grounds. Id. at 684, 208 S.E.2d at 689.

Because a utility's misconduct can justify both a penalty and a rate reduction, the Commission may not use a penalty to avoid its statutory duty

to decide whether a utility's costs are reasonable. Imposing a penalty on Duke was no substitute for disallowing its costs, as the law required here.

II. DUKE DID NOT SHOW THAT ITS COAL-ASH COSTS SHOULD BE INCLUDED IN DUKE'S RATE BASE.

In its orders, the Commission also held that Duke is entitled to recover a return on, and therefore profit from, its coal-ash disposal costs.[20] (Progress R p 706; Carolinas R p 1156) As shown below, this holding compounded one error with another.

Two categories of expenditures may be captured in rates: those that make up a utility's rate base and those that make up its operating expenses. See, e.g., Thornburg I, 325 N.C. at 467 n.2, 385 S.E.2d at 453 n.2; N.C. Gen. Stat. § 62-133(b). Only the utility's rate base, not its operating expenses, is

---

[20] This section of the brief discusses the Commission's handling of Duke's past coal-ash costs, because allowing Duke a recovery of those costs, with a return, increased current electrical rates.

The analysis here, however, applies equally to Duke's future coal-ash expenses. On those future expenses as well, the Commission ordered that Duke is entitled to accrue a return until its next general rate case. (Progress R p 706; Carolinas R p 1157)

eligible to be multiplied by a rate of return. Thornburg I, 325 N.C. at 475, 385 S.E.2d at 458.

This Court has enforced the distinction between rate bases and operating expenses. On at least three earlier occasions, it has reversed the Commission for putting property that was not used and useful into a utility's rate base.[21]

Here, Duke failed to show that its coal-ash costs meet the test for inclusion in its rate base. As shown below, Duke's coal-ash costs were not property that is used and useful for providing current service to consumers. Further, the three different rationales that the Commission offered for including Duke's costs in its rate base do not justify the Commission's

---

[21] Carolina Water, 335 N.C. at 507-08, 439 S.E.2d at 135 (reversing Commission's decision to put retired wastewater treatment plant into rate base); State ex rel. Utils. Comm'n v. Pub. Staff-N.C. Utils. Comm'n, 333 N.C. 195, 202, 424 S.E.2d 133, 137 (1993) [Carolina Trace] (reversing Commission's order that put into rate base a wastewater connection that a utility was no longer using); Thornburg II, 325 N.C. at 495, 385 S.E.2d at 469 (reversing Commission's decision to put costs to construct excess nuclear facilities into rate base); see also State ex rel. Utils. Comm'n v. Morgan, 277 N.C. 255, 273, 177 S.E.2d 405, 417 (1970) (holding that it was erroneous, before statutory amendment that authorized the practice, to put construction work in progress into rate base because the work in progress did not produce income during the test period).

decision. The Commission therefore erred by granting Duke a return on its coal-ash costs.

Finally, because Duke should not have received any return on its coal-ash costs at all, the penalty that the Commission imposed was illusory. That penalty simply reduced a return that Duke should never have received in the first place.

A. Duke's Coal-Ash Costs Were Not Spent on Property That Is Used and Useful for Providing Current Utility Service.

Duke's coal-ash costs were not spent on property that is used and useful for providing current service to Duke's customers.

As this Court has noted, "[t]here is but one rate base," namely, the rate base defined by the ratemaking statute. Morgan, 277 N.C. at 268, 177 S.E.2d at 414. In Thornburg II, this Court explained that, for everything other than construction work in progress, a two-part test decides what goes into a utility's rate base:

- First, the Commission must "determine the reasonable original cost of the property." 325 N.C. at 491, 385 S.E.2d at 466-67 (citing N.C. Gen. Stat. § 62-133(b)(1)).

- Second, the Commission must determine whether the property is "used and useful, or to be used and useful within a reasonable time after the test period." Id.

"If the costs in question do not meet both parts of the test, the costs may not be included in the rate base for ratemaking purposes." Id.

This Court's Carolina Trace opinion illustrates what it means for property to be used and useful for providing current utility service. 333 N.C. 195, 424 S.E.2d 133. One issue in Carolina Trace was whether the Commission had properly included in a utility's rate base the entire cost of a sewer connection that had been used for a time, but was abandoned by the time the rate case was filed. Id. at 197-99, 424 S.E.2d at 134-35. This Court reversed the Commission's order, because it was erroneous to allow the utility's rate base to include any completed facility that is not used and useful for providing current service. Id. at 202-03, 424 S.E.2d at 137.

Here, Duke made no attempt to show which (if any) of its coal-ash disposal costs were property that was used and useful for providing current service. The Commission, for its part, treated all of Duke's coal-ash costs the same for ratemaking purposes, whether they funded used and useful property or not.

As discussed below, the evidence here shows that Duke's coal-ash disposal costs were costs related to electrical service provided in the past, instead of being property that is used and useful for providing current electric service to customers.

By ruling to the contrary, the Commission has turned Duke's coal-ash disaster into "a new opportunity for capital investment and for profit-making" on Duke's part. (Carolinas R pp 1203-04 (Clodfelter, Comm'r, dissenting)) Those rulings overlooked the law on what belongs in a utility's rate base.

1. Duke did not show that its coal-ash disposal costs are property.

When the Commission allowed a return on Duke's coal-ash expenditures, the Commission treated those costs as property. N.C. Gen. Stat. § 62-133(b)(1), (4). That reasoning was an error, because Duke's coal-ash expenditures are not property at all.

Duke's coal-ash disposal costs do not fit any definition of property. Black's Law Dictionary defines property as "[c]ollectively the rights in a valued resource such as land, chattel, or an intangible" and as "[a]ny external thing over which the rights of possession, use, and enjoyment are exercised."

Property, Black's Law Dictionary 1410 (10th ed. 2014). Duke's coal-ash costs, in contrast, mainly involve preparing closure plans for coal-ash impoundments, treating contaminated groundwater, excavating coal ash, transporting it to landfills, and disposing of it. (See, e.g., Progress Doc. Ex. 567; Carolinas Doc. Ex. 3575) Those costs neither constitute property nor create property.[22]

In fact, both the Commission and Duke have admitted that Duke's coal-ash costs are not property investments, but operating expenses.

The Commission found that "a significant portion" of the coal-ash disposal costs at issue are operating expenses. (Carolinas R pp 1101-02)

Duke, for its part, has described its coal-ash costs as "non-capital costs, as well as the depreciation expense." (Progress R p 27; Carolinas R p 27 (emphasis added to each source)) Duke has distinguished those expenses from outlays that it classified as construction work in progress, such as costs related to Duke's conversion to dry-ash handling. (Progress R p 37; Progress

---

[22] Duke offered evidence that some of its coal-ash costs were spent to construct landfills, which could be considered property. (Progress Doc. Ex. 567; Carolinas Doc. Ex. 3575) However, for the cases at issue here, all of the landfill projects involve coal-fired power plants that are completely or partially retired. (Progress Doc. Ex. 508, 567; Carolinas Doc. Ex. 2338, 3575) As discussed below, investments in retired plants are not used and useful as a matter of law. See infra pp 75-76.

T 6 pp 303-04; Carolinas R p 37) Construction work in progress can be included in Duke's rate base. N.C. Gen. Stat. § 62-133(b)(1). Duke's non-capital operating expenses cannot. Id. § 62-133(b)(3).

2. Duke did not show which, if any, of its coal-ash costs were used and useful for providing service.

Duke's costs to dispose of many decades' worth of coal-ash waste fail the second part of the rate-base test as well: They are not "used and useful . . . in providing the service rendered to the public within the State." Id. § 62-133(b)(1). Instead, most or all of those costs relate to electric service provided to customers in the past.

In its Progress order, the Commission did not explain its reasons for concluding that Duke's coal-ash costs are used and useful. (Progress R pp 666-67)

In its Carolinas order, however, the Commission did state two reasons for this conclusion. First, the Commission reasoned that when Duke's coal-ash basins were originally constructed, they stored coal ash, which was a byproduct of energy generation. (Carolinas R p 1116) Second, the Commission reasoned that Duke's coal-ash costs are "intended to provide utility service in the present or the future through achieving their intended

purpose: environmental compliance, the retirement of ash impoundments, and the final storage location for the residuals of the generation of electricity." (Carolinas R p 1116)

Both of those rationales fail.

First, investments in facilities that are not used to provide current service, and that will never again be in use, may not, as a matter of law, be included in a utility's rate base. This Court's decisions make this point directly.

In Carolina Water, the Court held that it was an error of law for the Commission to accord rate-base treatment to a utility's investment in a retired wastewater-treatment plant. The Court stressed that "[t]here is no statutory authority for including in rate base costs from a completed plant that is no longer used and useful." Carolina Water, 335 N.C. at 508, 439 S.E.2d at 135 (citing Carolina Trace, 333 N.C. at 202, 424 S.E.2d at 137).

Likewise, in Carolina Trace, the property at issue was constructed, used for a time, and then rendered unnecessary before the company's next rate proceeding. 333 N.C. at 197-98, S.E.2d at 134-35. Because the property never qualified as used as useful for current service, the Court never allowed it to enter the utility's rate base. Id. at 202-03, 424 S.E.2d at 137.

As these cases show, the fact that property might have been used and useful for past service does not make that property used and useful for current service. Current service is the statutory test. N.C. Gen. Stat. § 62-133(b)(1).

To try to satisfy the used-and-useful requirement, the Commission stated that "in the case of Dan River, a new landfill is being constructed, which is a capital asset and used and useful." (Carolinas R p 1116) The Dan River plant, however, last provided utility service in 2012. (Carolinas Doc. Ex. 2338, 2340) The fact that the Commission relied on a landfill at a retired plant—one that handled coal ash from power generated years or decades ago—shows how far from this Court's precedents the Commission's orders strayed.

Indeed, the record here shows that most of Duke's coal-ash expenditures relate to retired plants or retired coal-ash ponds. Nine of Duke's sixteen plants, covering twenty-six of Duke's thirty-six coal-ash basins, were retired at the time these rate cases were filed. (Progress Doc. Ex. 508-09; Carolinas Doc. Ex. 2338, 2340) Coal-ash disposal costs at retired plants account for more than half of the coal-ash costs that Duke sought to recover in these rate cases. (Progress Doc. Ex. 568; Carolinas Doc. Ex. 3642)

Even at Duke's plants that continue to generate power, moreover, the coal ash was created when coal was burned to generate power years or decades ago. (Progress Doc. Ex. 339, 509; Carolinas Doc. Ex. 2340) In addition, at those power plants, some of the coal-ash ponds have been closed for years. (Progress Doc. Ex. 509; Carolinas Doc. Ex. 2340)

Thus, Duke is asking its current customers to pay to dewater, excavate, transport, and dispose of waste generated by coal that was burned as long ago as the 1960s. That past activity is in no way used and useful for providing current utility service to customers. It is unfair for make today's customers pay Duke a return for electric service to past customers.

Second, the Commission also seems to have held that Duke's coal-ash costs could be included in Duke's rate base because those costs were useful for environmental compliance. (Carolinas R p 1114) That reasoning, too, was erroneous.

The Commission's logic confuses reasonableness, the standard for including <u>any</u> costs in rates, with used-and-useful status, the additional standard that must be met to include costs in a utility's rate base. Environmental-compliance costs can be reasonable (and thus recoverable as costs) and still fail the higher standard for generating a return: being used

and useful for providing current electric service. The Commission's holding that environmental-compliance costs are used and useful because those costs are legitimate overlooks the distinction between costs and a utility's rate base.

This Court itself has followed the distinction between reasonable costs and used and useful investments. For example, in Thornburg II, this Court affirmed the Commission's conclusion that certain expenditures on facilities were prudent. 325 N.C. at 493, 385 S.E.2d at 468. Even so, the Court held that, as a matter of law, the utility could not receive a return on these expenses, because the facilities at issue were not used and useful for current service. Id. at 496, 385 S.E2d at 470.

Indeed, the Commission itself has followed this distinction in an earlier rate case. See Pub. Serv. Co. of N.C., No. G-5, Sub 327, slip op. at 20-23, 84th Rep. 159, 177-81 (N.C. Utils. Comm'n Oct. 7, 1994). That case addressed the costs of cleaning up environmental contamination at Public Service Company's manufactured-natural-gas plants. Id. at 23. The Commission held that, as a matter of law, the utility could not receive a return on clean-up costs at sites that were not providing current service to customers. Id.

In fact, even when an environmental regulator orders a utility to make capital improvements, those capital outlays are not automatically entitled to be included in the utility's rate base. In Florida Cities, for example, a utility updated its wastewater plant to comply with a consent order entered by a state environmental regulator. Fla. Cities Water Co. v. Fla. Pub. Serv. Comm'n, 705 So. 2d 620, 623 (Fla. Dist. Ct. App. 1998). Even though the upgrade was required by the regulator, and even though the upgrade was deemed to serve the public interest, the court held that the Florida Public Service Commission acted correctly by making its own decision on the extent to which the improvements were used and useful for wastewater service. Id. at 623-24. In reaching this conclusion, the court followed this Court's teachings. Id. (citing Carolina Trace, 333 N.C. at 207, 424 S.E.2d at 140).

As these decisions illustrate, the Commission erred here by holding that Duke's costs for closing its coal-ash basins were used and useful for providing current service.

Despite this fact, the Commission awarded Duke a return on its coal-ash expenses. It offered three reasons for doing so:

- First, it reasoned that granting a return to Duke was required by accounting rules.
- Second, it concluded that giving Duke a return was required because investors provided the funds that Duke spent on closing its coal-ash basins.
- Third, the Commission held that it could properly exercise its discretion to grant a return.

As shown below, all of those conclusions were erroneous. None of them could override the ratemaking statute's command that a return may be earned only on used and useful property.

B. Duke's Creation of Asset Retirement Obligations Does Not Entitle Duke to a Return on Expenditures That Are Not "Property Used and Useful" In Providing Utility Service.

First, the Commission erred by concluding that Duke's accounting treatment of its coal-ash costs controlled how those costs should be treated for ratemaking purposes.

In 2015, in light of Duke's obligation to close its coal-ash basins, Duke recorded an asset retirement obligation (ARO), citing Generally Accepted Accounting Principles, Federal Energy Regulatory Agency accounting rules,

and an accounting standard: ASC 410-20.[23] (Progress R pp 3, 5-6; Carolinas R pp 3, 5-6) ASC 410-20 requires publicly traded companies to record an ARO whenever they have a legal obligation to incur costs to retire a long-lived asset and that obligation can be quantified. (See Progress R pp 3-4; Carolinas R pp 3-4)

AROs state a company's estimate of the fair value of its liability. (See, e.g., Progress R p 7; Carolinas R p 7; Carolinas Doc. Ex. 548) On a company's balance sheet, the value of an ARO is presented as a liability, with an offsetting entry on the asset side of the balance sheet. (Carolinas R p 1191; Carolinas Doc. Ex. 546) Here, Duke's AROs, representing the total estimated value of Duke's coal-ash disposal liabilities as of September 2016, amounted to about $2.1 billion for Carolinas and about $2.4 billion for Progress. (Progress R p 22; Carolinas R p 22)

Duke also made balance-sheet entries to reflect its actual cash expenditures on closing its coal-ash basins. (Progress R p 9; Carolinas R p 9) These entries—known as regulatory deferral accounts—are distinct from the AROs. As of December 2016, the expenses in these accounts were $434.4

---

[23] ASC 410-20 was formerly called Statement of Financial Accounting Standard (SFAS) 143. (Carolinas T 12 p 63)

million for Carolinas and $291.9 million for Progress. (Progress R p 15; Carolinas R p 15)

In its order that set rates for Progress, the Commission reasoned that the costs that Progress put in an ARO "are eligible for ratemaking treatment as though they are used and useful assets." (Progress R p 675) The Commission used similar reasoning in its Carolinas order. There, it stated that a "significant portion" of Carolinas' coal-ash expenses would have been operating expenses "had they not been accounted for in an ARO and deferred." (Carolinas R p 1101)

As Commissioner Clodfelter recognized in his dissent, however, the existence of an ARO does not require a finding that Duke's coal-ash removal costs are "property used and useful . . . in providing the service to be rendered to the public." (Carolinas R p 1190) Indeed, even if the existence of an ARO did "produce such a result, that result is in conflict with the statutory language and structure of G.S. 62-133 and cannot be accepted." (Carolinas R p 1190)

Commissioner Clodfelter was right. The accounting principles that Duke cited here governed Duke's financial statements to investors. Duke acknowledged that these accounting principles did not govern Duke's

financial reporting to the Commission, let alone the Commission's own ratemaking analysis. (Carolinas T 12 p 93; see also Progress R p 9; Carolinas R p 9) The accounting treatment adopted by a utility—even when approved by the Commission—cannot and does not "create a liability upon the company's customers or establish the company's right to recover from its customers the amounts so entered." Edmisten, 291 N.C. at 464, 232 S.E.2d at 191; accord N.C. Power, 338 N.C. at 421-22, 440 S.E.2d at 901-02; Carolina Trace, 333 N.C. at 203, 424 S.E.2d at 138.

The Commission itself has recognized this principle in other cases. In 2003, the predecessors of Carolinas and Progress sought permission to put certain ARO costs into deferred accounts. Duke Power Co., No. E-7, Sub 723, slip op. at 12, 2003 WL 21049616 (N.C. Utils. Comm'n Apr. 4, 2003); Carolina Power & Light Co., No. E-2, Sub 826, slip op. at 13, 2003 WL 22138556 (N.C. Utils. Comm'n Aug. 12, 2003). The Commission granted the deferral request, but took pains to specify that "no portion of the total ARO asset or liability shall be included in rate base for North Carolina retail accounting or ratemaking purposes." Duke Power, No. E-7, Sub 723, slip op. at 12; Carolina Power & Light, No. E-2, Sub 826, slip op. at 13. This distinction, which the

Commission itself drew in 2003, is the same one that the Commission overlooked here.

For these reasons, the Commission erred by allowing Duke's accounting treatment of its coal-ash costs to control the Commission's treatment of those costs for ratemaking.

C. VEPCO Does Not Allow Duke To Receive a Return.

When the Commission created a new—and erroneous—test for what can be included in a utility's rate base, the Commission also strayed from this Court's teachings in State ex rel. Utilities Commission v. Virginia Electric & Power Co., 285 N.C. 398, 206 S.E.2d 283 (1974) [VEPCO]. In VEPCO, this Court held that working capital may be included in a utility's rate base. Id. at 414-15, 206 S.E.2d at 295-96. The Court defined working capital as "the utility's own funds reasonably invested in . . . materials and supplies and its cash funds reasonably so held for the payment of operating expenses, as they become payable." Id.

Here, the Commission read VEPCO to hold that all capital supplied by investors must be included in Duke's rate base. (Progress R pp 673-74;

Carolinas R pp 1114-15) It reasoned that because "these funds are 'property' of [Duke]," Duke should be able to earn a return on them. (Carolinas R p 1116)

As shown below, that reasoning was erroneous in at least two ways. First, it holds, contrary to this Court's decisions, that a utility's rate base includes all investor-supplied capital, not just capital that qualifies as used and useful. Second, in any event, the Commission misconstrued the record here when it stated that Duke's coal-ash costs were funded by working capital.

1. Investor-supplied capital is a necessary, but not sufficient, basis for putting assets into a utility's rate base.

Here, the Commission misunderstood the relationship between investors' capital and a utility's rate base. Under North Carolina law, the provision of capital by investors is a necessary condition, but not a sufficient basis, for putting assets into a utility's rate base. For an asset to get rate-base treatment, it must not only have been funded by the utility's investors, but must also be used and useful for providing utility service.

In Morgan, this Court made clear that the mere fact that investors have funded certain expenses is not enough to allow a utility to put those expenses in its rate base. There, the Court held that the Commission erred

by giving a utility a return on its investments in a facility that was still under construction and not yet in use. 277 N.C. at 273, 117 S.E.2d at 417. If all capital supplied by investors were entitled to be treated as working capital—as the Commission erroneously reasoned here—the Morgan Court would have allowed the investments at issue to go into the utility's rate base. The Court, however, did the opposite.

The Court has applied this same analysis in multiple other cases. Again and again, the Court has held that a utility's rate base excluded property that was presumably funded by investors, but that failed the additional requirement of being used and useful:

- In Thornburg II, the issue was whether a utility's rate base could include the parts of common facilities that served three abandoned units at the Shearon Harris nuclear plant. 325 N.C. at 486, 385 S.E.2d at 464. This Court held that as a matter of law, these excess facilities were not used and useful. Id. at 495, 385 S.E.2d at 469.
- In Carolina Water, a utility was facing unrecovered costs that resulted from the early retirement of a wastewater-treatment plant. 335 N.C. at 507, 439 S.E.2d at 135. The Court held that

including these costs in the utility's rate base was erroneous. That outcome, the Court held, would allow the utility "to earn a return on its investment at the expense of the ratepayers." Id. at 508, 439 S.E.2d at 135.

- In Carolina Trace, as noted above, the Court barred a utility from receiving a return on any part of its investment in a sewer connection that was constructed and abandoned during the time between the utility's rate cases. 333 N.C. at 203, 424 S.E.2d at 137. Because of that timing, the property never qualified as used and useful. Id.

In short, this Court has never recognized any exceptions to the "used and useful" requirement. There is no working-capital exception. There is no exception for funds supplied by investors.

The record before the Commission here shows that Duke's coal-ash expenses failed the used-and-useful requirement. A witness testified specifically that Duke's coal-ash expenses have nothing to do with "the Company's forward-looking obligation to provide utility service." (Carolinas

T 22 p 81) As this testimony verified, Duke's coal-ash costs are not used and useful.

In sum, the Commission's analysis of working capital here negates the statutory command that only used and useful assets may be included in a utility's rate base. N.C. Gen. Stat. § 62-133(b)(1). As a result, the Commission erred by reasoning that VEPCO entitled Duke to a return on its coal-ash costs.

2. Duke's coal-ash costs are not working capital in any event.

In any event, Duke did not establish here that its coal-ash costs were funded by working capital.

The Commission's orders do not make clear whether the Commission actually concluded that Duke's coal-ash costs were working capital. (See Progress R pp 673-74; Carolinas R pp 1114-15) If the Commission did reach such a conclusion, however, that conclusion would not be supported by substantial evidence.

In both of these cases, no witness for Duke actually testified that its coal-ash expenditures were funded by working capital.

In the Progress order, the Commission relied on the fact that Duke had recorded its coal-ash expenses in a working-capital section in Progress's books. (Progress R p 673) In the Carolinas case, however, a Duke witness testified directly that the company does not believe that booking coal-ash costs in a working-capital account, by itself, is enough to turn those costs into part of Duke's rate base. (See Carolinas T 6 p 318) Instead, "[t]he Company's position [was] that rate base represents investor supplied funds and it is this characteristic that makes the deferred coal-ash cost a legitimate component of rate base." (Carolinas T 6 p 318)

Other than that circular "position," Duke offered no evidence that it was drawing on working capital to meet its coal-ash expenses. As evidence of its working-capital needs, Duke relied only on a 2011 analysis that it had used in earlier rate cases, before it began its clean-up of coal ash. (Progress T 10 p 86; Carolinas T 12 p 50). Because that 2011 analysis could not describe Duke's post-2014 cash flows, the analysis offered no evidence that Duke needed to draw on working capital to fund its post-2014 coal-ash costs. (Progress R p 751; Carolinas R p 1202)

In sum, Duke did not show that it relied on new investor funds to pay its coal-ash costs. That gap in the record confirms that the working-capital analysis in VEPCO does not apply here.

D. The Commission Lacks Discretion to Allow a Utility's Rate Base to Include Property That Is Not Used and Useful for Providing Service.

The Commission also erred by holding that it could exercise its discretion to grant Duke a return on its coal-ash costs.

In its Progress order, the Commission stated: "[W]ere the 'used and useful' decision the Commission has reached be found to be in error, the Commission would nevertheless approve the Company's cost recovery proposal in all respects, and would exercise its discretion to achieve that result." (Progress R p 674 n.29) Later, the Commission stated even more directly that it had relied on discretion when it awarded Duke a full return on its unamortized coal-ash costs. (Progress R p 951)

Similarly, in the Carolinas order, the Commission held that it was exercising its discretion "as expressly authorized by N.C. Gen. Stat. § 62-133(d)" to put the unamortized balance of the coal-ash disposal costs into Carolinas' rate base. (Carolinas R pp 1099-1100)

Those holdings were erroneous. North Carolina law makes clear that the Commission has no discretion to give rate-base treatment to something that is not used and useful for providing service to customers now or within a reasonable time. This Court has made this point on multiple occasions.[24]

In Carolina Trace, for example, the Commission held that a particular sewer connection was not used and useful for serving customers. Despite that fact, the Commission allowed the value of the sewer connection to be put into the utility's rate base. The Commission reasoned that this rate-base treatment would allow the utility to "recover its investment in plant that at one time was used and useful to provide service." Carolina Trace, 333 N.C. at 200, 424 S.E.2d at 136.

This Court reversed, holding that the utility could not recover its investment, let alone receive a return on that investment. See id. at 202, 424 S.E.2d at 137. The Court found it pivotal that "[t]here is no statutory authority anywhere within Chapter 62 that permits the Commission to include in rate base any completed plant . . . that is not 'used and useful' within the meaning of this term as defined in our case law." Id. at 203, 424

---

[24] See Carolina Water, 335 N.C. at 507-08, 439 S.E.2d at 135; Carolina Trace, 333 N.C. at 202, 424 S.E.2d at 137; Thornburg II, 325 N.C. at 495, 385 S.E.2d at 469.

S.E.2d at 137; accord Carolina Water, 335 N.C. at 508, 439 S.E.2d at 135 (citing Carolina Trace, 333 N.C. at 202, 424 S.E.2d at 137).

The Court has followed this same analysis in several other decisions that have reversed the Commission for giving rate-base treatment to expenditures that were not used and useful. See, e.g., Carolina Water, 335 N.C. at 507-08, 439 S.E.2d at 135; Thornburg II, 325 N.C. at 484, 385 S.E.2d at 463. In none of those decisions has the Court ever suggested that the Commission has discretion to expand a utility's rate base beyond the specific definition of that term in section 62-133(b).

To be sure, the law gives the Commission discretion on certain other issues. That discretion, however, does not extend to the makeup of a utility's rate base.

For example, the ratemaking statute provides that the "Commission shall consider all other material facts of record that will enable it to determine what are reasonable and just rates." N.C. Gen. Stat. § 62-133(d). That statute, however, "is not a grant to roam at large in an unfenced field." State ex rel. Utils. Comm'n v. Pub. Serv. Co., 257 N.C. 233, 237, 125 S.E.2d 457, 460 (1962).

This Court's decisions show that the discretion granted by section 62-133(d) is not nearly as broad as the discretion the Commission purported to exercise here.

In Public Service, the Commission engaged in "juggling figures" to arrive at a particular rate of return. Id. at 236, 125 S.E.2d at 459. In its order, the Commission stated that it had considered "all other facts which we feel have a bearing upon our conclusion—without reference to specific formula." Id. at 237, 125 S.E.2d at 460 (emphasis deleted) (quoting Commission order). In reversing the Commission's decision, this Court held that the statutory grant of discretion that is now codified in N.C. Gen. Stat. § 62-133(d) does not allow the Commission to depart from the statutory ratemaking formula. To the contrary, when the Court has decided what belongs in a utility's rate base, it has applied that statutory concept with strict attention to its limits. See N.C. Gen. Stat. § 62-133(b)(1); supra pp 69 n.21, 70-71, 75-76 (discussing the Court's decisions under section 62-133(b)).

For these reasons, the Commission erred by holding that it had discretion to allow Duke to receive a return on its coal-ash costs—that is, to allow Duke to profit from cleaning up its coal ash and the pollution it caused.

E. Because the Management Penalties Here Were Deducted From a Return That Duke Should Not Have Received, the Penalties Were Illusory.

Finally, the Commission's "management penalties" against Duke are illusory. Those penalties simply reduced a return that Duke never should have received in the first place.

The Commission has awarded Progress a gross return of about 12 million dollars per year,[25] reduced by the management penalty of about six million dollars per year. (Progress R p 706; Progress Doc. Ex. 1378) Thus, over the five-year coal-ash cost recovery period, even after the penalty, Progress will still receive a return of about 30 million dollars for closing its coal-ash basins and cleaning up the pollution that it caused.

Under a parallel calculation, even after one deducts the Commission's management penalty, Carolinas' five-year return on its coal-ash costs will be about 50 million dollars. (Carolinas R p 1156; Carolinas Doc. Ex. 5376)

As these figures show, the management penalty that the Commission imposed on Duke was a mirage. If the Commission had not erred by

---

[25] As noted, the calculation cited above includes the effects of compounding. The calculation is based on Progress's initial request to recover $241 million from its customers. See supra p 11 n.7.

granting Duke a return on its coal-ash costs, the management penalty would have been zero. (Carolinas R p 1190 (Clodfelter, Comm'r, dissenting))

Thus, instead of penalizing Duke for mismanaging its coal ash, the Commission has rewarded Duke. It has allowed Duke to profit from its unreasonable decision to put its coal ash in unlined basins that have polluted the waters of this state. The Commission's decision to impose an illusory penalty on Duke does not offset the Commission's erroneous approval of Duke's costs, let alone the Commission's erroneous inclusion of those costs in Duke's rate base.

CONCLUSION

The Attorney General respectfully requests that this Court reverse the orders of the Commission and remand these appeals for Duke's coal-ash costs to be disallowed. Alternatively, the Attorney General requests that this Court vacate the Commission's orders and remand these cases for further proceedings.

This 26th day of April, 2019.

JOSHUA H. STEIN
Attorney General

Electronically Submitted
Matthew W. Sawchak
Solicitor General
N.C. State Bar No. 17059
msawchak@ncdoj.gov

N.C. App. R. 33(b) Certification: I certify that the lawyers listed below have authorized me to list their names on this brief as if they had personally signed it.

James W. Doggett
Deputy Solicitor General
N.C. State Bar No. 49753
jdoggett@ncdoj.gov

Jennifer T. Harrod
Special Deputy Attorney General
N.C. State Bar No. 26968

jharrod@ncdoj.gov

Teresa L. Townsend
Special Deputy Attorney General
N.C. State Bar No. 13460
ttownsend@ncdoj.gov

Margaret A. Force
Assistant Attorney General
N.C. State Bar No. 15861
pforce@ncdoj.gov

Matt Burke
Solicitor General Fellow
N.C. State Bar No. 52053
mburke@ncdoj.gov

N.C. Department of Justice
Post Office Box 629
Raleigh, NC 27602
Phone: (919) 716-6400

Counsel for the Attorney General