DOCKET NO. M-100, SUB 145

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

In the Matter of Rulemaking Proceeding to Consider Proposed Rule Establishing Procedures for Settlements and Stipulated Agreements	)))	INITIAL COMMENTS OF THE PUBLIC STAFF

NOW COMES THE PUBLIC STAFF – North Carolina Utilities Commission ("Public Staff"), by and through its Executive Director, Christopher J. Ayers, and pursuant to the Order of the Commission issued on August 1, 2016, respectfully submits the following comments on the rule proposed by North Carolina Waste Awareness and Reduction Network, Inc. ("Petitioner"), in its petition filed on July 14, 2016, in the above-captioned docket.

Petitioner proposes a rule to establish procedures for settlements and stipulated agreements in matters before the Commission. Petitioner contends that the current process is "most unfair and nontransparent" in that bilateral settlement agreements are often reached through negotiations that exclude other parties and before those parties have had the opportunity to file testimony or complete discovery on the initial application and before an evidentiary hearing has been held. Petitioner also complains that such agreements contain clauses providing that no portion of the agreement will be binding on the parties unless the entire agreement is accepted by the Commission. Petitioner's grievances about the current settlement process, and the procedures by which Petitioner proposes to address those grievances, reveal either a fundamental lack of understanding of the role settlements play in utility regulation or a desire to obstruct the settlement process, or both.

The Public Staff opposes the rule proposed by Petitioner on the grounds that it is unnecessary and would serve to hinder good faith negotiations between parties in Commission proceedings, which runs contrary to established public policy. There a long history of parties in utility cases working together to resolve issues informally through settlement. N.C.G.S. § 62-69(a) provides that the Commission "shall encourage the parties and their counsel to make and enter stipulations of record" for the purposes of avoiding the need to prove all facts, facilitating the use of exhibits, and clarifying issues of fact and law. The statute also permits the Commission to make "informal disposition of any contested proceeding by stipulation, agreed settlement, consent order or default." The value of settlements has also been recognized by the courts, both in utility regulation and in general business litigation. *State ex rel. Util. Comm'n v. Carolina Util. Customers Ass'n*, 348 N.C. 452, 466, 500 S.E.2d 693, 703 (1998) ("[T]his Court recognizes the crucial role that information disposition plays in quickly and efficiently resolving many contested proceedings and encourages all parties to seek such resolution through open, honest and equitable negotiation."); *Knight Publ'g Co. v. Chase Manhattan Bank*, 131 N.C. App. 257, 262, 506 S.E.2d 728, 731 (1998) (stating that "the law favors the avoidance of litigation").

Settlements promote informed decision-making and the efficient administration of justice, especially where complex technical matters are at issue as is typical of Commission proceedings. A key benefit of settlement discussions is the informal exchange of ideas and information between the parties, which leads to greater understanding of interests and objectives. Settlement discussions also

facilitate the utilization of parties' technical proficiencies and enable parties to find creative solutions to new challenges that may not have been addressed through the existing statutory or regulatory framework.

Additionally, the opportunity for accountants, economists, engineers, and attorneys to confer with their counterparts in an informal setting frequently resolves issues that arise merely due to misunderstanding, mistake, or lack of information. Even if these discussions do not result in a formal stipulation, there is value in eliminating insignificant or noncontroversial issues ahead of an evidentiary hearing so that the parties and Commission can focus on the genuine disputes. Moreover, partial settlements allow the parties to narrow the issues for consideration by the Commission, which shortens hearing lengths, expedites decision-making, and reduces costs to the parties involved. This results in savings to consumers by reducing litigation expenses that would otherwise be recoverable as a component of the cost of providing utility service.

In support of its proposed rule, Petitioner cites an essay titled *Regulatory Settlements: When Do Private Agreements Serve the Public Interest?* and written by Scott Hempling, a recognized expert in public utility law and regulation and former Executive Director of the National Regulatory Research Institute.[1] The apparent thrust of Mr. Hempling's essay is a concern that settlements can "edge the commission out of its statutory role" and "induce regulatory passivity." Mr. Hempling expresses particular concern about "resource differentials" between

[1] A copy of this essay is attached to the petition as Exhibit B.

parties representing private interests and those representing "the public interest spectrum."

Concerns about a resource differential between utilities and consumers in Commission proceedings were addressed by the General Assembly many years ago with the enactment of N.C.G.S. § 62-15 and the designation of some 87 former Commission staff positions as the Public Staff. Under the sole supervision, direction, and control of an Executive Director appointed by the Governor, the Public Staff has been given extensive duties and responsibilities to perform on behalf of the using and consuming public along with broad investigative authority. N.C.G.S. §§ 62-15(d), 62-34(b), and 62-51. The Public Staff is entirely independent of the Commission in the performance of its duties. It is subject to N.C.G.S. § 62-70, which governs *ex parte* communications with the Commission, and has the right of appeal from Commission orders pursuant to N.C.G.S. § 62-90. Together, these and other statutory changes significantly altered the balance of resources in Commission proceedings.

Petitioner also cites cases in which settlements were reached between utilities and the Public Staff and were approved by the Commission despite Petitioner's opposition[2] and argues that those settlements were presented as a *fait accompli*. This argument implies that the Commission is either averse to or incapable of engaging in independent thought and demonstrates a misunderstanding of the basic parameters by which the Commission must review and weigh stipulations and settlement agreements in making its decisions. The

[2] A list of those cases is attached to the petition as Exhibit A.

Commission is responsible for weighing all of the evidence in the record and must render an independent decision supported by that evidence.[3] The North Carolina Supreme Court clearly articulated this principle in *Carolina Util. Customers Ass'n*, 348 N.C. at 466, 500 S.E.2d at 703:

> Thus, we hold that a stipulation entered into by less than all of the parties as to any facts or issues in a contested case proceeding under chapter 62 should be accorded full consideration and weighed by the Commission with all other evidence presented by any of the parties in the proceeding. The Commission must consider the nonunanimous stipulation along with all the evidence present and any other facts the Commission finds relevant to the fair and just determination of the proceeding. The Commission may even adopt the recommendations or provisions of the nonunanimous stipulation as long as the Commission sets forth its reasoning and makes "its own independent conclusion" supported by substantial evidence on the record that the proposal is just and reasonable to all parties in light of all the evidence presented.

The Supreme Court has further affirmed that Commission orders accepting unanimous or nonunanimous stipulations should not be subjected to higher or lower standards of review on appeal.

> [T]he proper standard of review requires only that the Commission make an independent determination supported by substantial evidence on the record. Even where the parties negotiate a private agreement regarding the evidence to be presented, the Commission satisfies the requirements of chapter 62 by independently considering and analyzing all the evidence and any other facts relevant to a determination that the proposal is just and reasonable to all parties.

State ex rel. Util. Comm'n v. Carolina Util. Customers Ass'n, 351 N.C. 223, 231, 524 S.E.2d 10, 16-17 (2000).

[3] The Commission has routinely probed the terms of both unanimous and nonunanimous stipulations and, in some instances, has revised or rejected the terms of a stipulation.

Petitioner objects to standard settlement language that binds the parties to a stipulation only to the extent the agreement is accepted by the Commission in its entirety. Instead of minimizing the Commission's authority or otherwise altering the standard for decision-making, as Petitioner implies, this language protects the stipulating parties against the very fact that the stipulation is not a *fait accompli* and the Commission is free modify or reject it. The purpose behind the language to which Petitioner objects is to protect the parties against losing the benefit of their bargain should the Commission choose to reject some or all of the stipulation.

A stipulation is a product of comprehensive give-and-take negotiations in which parties make concessions on some issues in exchange for favorable results on other issues. The trade-offs can vary depending upon the motivations of the parties, the parties' assessments of the probability of prevailing on the merits, and the materiality of the issues. Settlements are reached when parties reach a point where they believe their respective negotiated results equal or exceed the results they could reasonably expect to obtain through litigation. If a portion of the consideration exchanged to achieve those results is rejected by the Commission, the parties must be allowed to protect their interests through litigation. Without the language Petitioner opposes, the Commission could pick and choose among the stipulated terms and arrive at results far different from those negotiated by the parties, who would nonetheless be contractually obligated to support the terms accepted by the Commission while being deprived of the benefit of the entire agreement. Such a result is completely contrary to the purpose of negotiated settlements and would render the entire negotiation process meaningless. This is

only one of the flaws in the rule proposed by Petitioner. Others are discussed below.

First, the proposed rule omits any parameters for maintaining confidentiality in settlement discussions involving proprietary and trade secret information that is filed with the Commission under seal. Any rule outlining procedures for a settlement process should require each party to sign a confidentiality agreement prior to participating in discussions. If a party has good faith intentions to engage in settlement talks with other parties in a proceeding, that party should be willing to sign and abide by the standard confidentiality agreement signed by other parties. It is impractical to allow a party to participate in settlement discussions otherwise, as that party lacks the full picture and information necessary to meaningfully participate. Additionally, the parties should be required to affirm compliance with North Carolina Rule of Evidence 408, which prohibits the admission of evidence related to settlement discussions. These well-established and accepted principles are necessary to productive settlement negotiations, and all parties should be required to adhere to them before being allowed to participate in settlement discussions.

Second, the prohibition on filing settlements before intervention/testimony deadlines have passed nullifies the statutory goal of promoting judicial economy and appears to be a thinly veiled attempt to require the stipulating parties to provide other parties with a basis for opposing a stipulation without conducting any discovery. One of the benefits of reaching a settlement earlier in the process is that it affords the stipulating parties the opportunity to avoid expending time and

resources preparing testimony and exhibits that are superseded by a settlement and supporting testimony and thus serve no legitimate legal purpose. A likely consequence of Petitioner's proposal would be to encourage stipulating intervenors to let the initial testimony deadline pass and simply file a stipulation and supporting testimony afterward. This would directly impact the ability of non-stipulating parties to conduct discovery and prepare for hearing, thus defeating the ostensible purpose of Petitioner's proposal.

Third, the timelines in the proposed rule are unrealistic and reflect a complete lack of understanding of the settlement process. Petitioner incorrectly assumes that all settlement negotiations are identical and thus suited to a one-size-fits-all procedure. Parties who regularly participate in settlement negotiations know that such discussions do not fit any single timeline or form but vary widely depending on the nature of the case and the sophistication and diligence of the parties. Constructive settlement discussions only become possible as the parties develop their respective cases through discovery and analysis and determine that a good faith opportunity exists to explore resolving some or all of the issues. The timeline required for determining whether or not settlement discussions are warranted varies from case to case, and once begun, actual negotiations can range from days to months.

Settlement discussions are significantly more complex than Petitioner appears to realize. They quickly devolve from across-the-table sessions to simultaneous discussions between subject matter experts involving the back-and-forth exchange of data and information by email, telephone, and individual

meetings. This free flowing exchange of information is critical to identifying areas of possible agreement. The larger the number of parties in a case, the longer it takes for information to be exchanged and settlement negotiations to occur. In some cases, negotiations occur in sequence with respect to issues and parties, thereby necessitating that baseline issues be resolved before other issues can be addressed. For example, it is difficult to negotiate rate design in a general rate case if a revenue requirement has not yet been established. All of these factors weigh heavily against imposing rigid guidelines on the settlement process.

Fourth, Petitioner's proposed rule is illusory, since it does not adequately define the "opportunity to participate." The opportunity to participate can mean different things to different parties depending upon their interests and goals. As discussed above, settlement discussions are typically very fluid and involve the exchange of ideas and information between groups and individuals through various means, sometimes simultaneously. Including every party on every communication is simply not possible. This is a practical reality that most parties appear to recognize and accept as part of the settlement process.

While parties may claim that they want to participate in settlement negotiations, not all parties approach such negotiations in good faith or with reasonable expectations. Additionally, some parties come into settlement negotiations unprepared to participate, having conducted little or no discovery beforehand. The presence of such parties can muddle the issues and hinder the negotiating process for those who have invested valuable time and resources in making the process work. Any rule governing the settlement process should

contain a provision requiring good faith participation in the process and include a mechanism for excluding parties seeking to delay or obstruct negotiations.

Finally, the proposed rule threatens the constitutional rights of parties to form contracts without government restrictions.[4] "Freedom of contract, unless contrary to public policy or prohibited by statute, is a fundamental right included in our constitutional guarantees." *Muncie v. Ins. Co*., 253 N.C. 74, 79, 116 S.E.2d 474, 478 (1960).

> As said by Walker, J., in *Stephens v. Hicks*, 156 N.C. 239, 72 S.E. 313; "Parties are entitled to contract according to their free will. They make contracts for themselves and not by legislative compulsion. The freedom of the right to contract has been universally considered as guaranteed to every citizen."
>
> "The privilege of contracting is both a liberty and a property right. *Furniture Co. v. Armour*, 345 Ill. 160. The right to contract is recognized as being within the protection of the Fifth and Fourteenth Amendments to the Constitution of the United States (citing authorities); and protected by state constitutions. 'It has been held that the right to make contracts is embraced in the conception of liberty as guaranteed by the Constitution.' . . . 'Included in the right of personal liberty and the right of private property -- partaking of the nature of each -- is the right to make contracts for the acquisition of property.'" *Morris v. Holshouser*, 220 N.C. 293, 17 S.E. 2d 115; 11 Am. Jur. 1153. The Legislature has the power to impose reasonable restrictions on the right to contract when the restrictions imposed are conducive to public good. As said by Mr. Justice Butler in *Advance-Rumley Thresher Co. v. Jackson*, 287 U.S. 283, 77 L.Ed 306, 53 S Ct. 133, 87 ALR 285: "But freedom of contract is the general rule and restraint the exception. The exercise of legislative authority to abridge it can be justified only by the existence of exceptional circumstances."

Alford v. Textile Ins. Co., 248 N.C. 224, 227, 103 S.E.2d 8, 10-11 (1958).

Parties appearing before the Commission advocate for outcomes that are in the best interest of their respective constituencies, whether through litigation or

[4] This may explain why Petitioner was unable to find any precedent for its proposed rule.

settlement. Each of these parties has a constitutional right to choose with whom to contract, whether or not to contract, and the terms on which to contract to achieve their goals. All parties before the Commission are currently free to negotiate with one another – or not. Petitioner's proposed rule seeks to force parties to negotiate by prohibiting a settlement with any party unless the negotiation includes all parties. No party should be forced to engage in settlement discussions with parties that are abusive, advocate irrelevant issues, negotiate in bad faith, or maintain irrational expectations.

The proposed rule further limits the ability of parties to freely contract by confining them to narrow timelines and procedures for discussing settlement. The constitutional right to contract includes the ability to negotiate without restrictions that make settlement difficult, if not impossible. The proposed rule also seeks to remove constitutional protections by requiring stipulating parties to remain bound to a stipulation even if the Commission materially alters its terms. In such scenarios, the parties would lose their ability to benefit from the bargain reached following arms-length negotiations and instead have contract terms imposed upon them without recourse.

Petitioner may contend that a rule prescribing settlement procedures passes constitutional muster because the proposed limitations advance a public good by protecting customers against public utilities. Such an argument confuses the roles of the parties with the role of the Commission. Regardless of whether some or all of the parties enter into a stipulation, the Commission remains responsible for making decisions that are just and reasonable to utilities,

consumers, and other parties with a real interest in the proceedings. So long as the Commission remains the arbiter of all cases brought before it, there is no public interest that justifies a rule abridging the right of parties to freely contract. To the contrary, the General Assembly expressed its intent in N.C.G.S. § 62-69(a) that parties should be encouraged to exercise that right through agreed settlements in contested proceedings as a matter of public policy. The Commission should refrain from adopting any rule or procedure that would undermine the policy objectives of the statute by impeding the ability of parties to resolve complex technical issues economically and efficiently through free and open negotiations.

Over the years, experience has shown that comprehensive settlements between utilities and the Public Staff, supplemented on occasion with bilateral agreements between utilities and other parties, have produced positive results for consumers. For concrete examples one need only look at the cases listed in Petitioner's Exhibit A, where settlements achieved benefits for consumers that the Commission could not have ordered on its own in the form of monetary concessions and regulatory conditions.

Mr. Hempling writes in his essay:

> Settlements are appropriate when they help a commission carry out its public-interest obligations. Favorable conditions include: (1) The settlement subject demands technical proficiency, (2) the parties' proficiency exceeds the commission's, and (3) the parties' private interests are aligned with the long term public interest.

All of these conditions were present in the cases listed in Exhibit A.

The settlements in those cases were reached through "expert idea sharing" after months' long investigations involving hundreds of highly technical data

requests. During the investigation periods, other parties had the opportunity to participate fully by entering into confidentiality agreements with utilities and gaining access to confidential and proprietary information provided to the Public Staff; by conducting additional discovery of their own; by employing experts to assist them in analyzing the information they obtained; and by using that information in their own negotiations with utilities on issues of importance to them. They also had the opportunity to bring issues to the Public Staff's attention and to seek the Public Staff's assistance in understanding technical aspects of the various cases. This is a process that has been followed for years, and there is nothing opaque or secretive about it. Any perceived barriers to a party's participation in the process would have been largely of the party's own making.

For all of the foregoing reasons, the Public Staff submits that the rule proposed by Petitioner is not only unnecessary but also would undermine longstanding principles, policies, and procedures that have served the public interest well. The petition should therefore be denied.

Respectfully submitted this the 16th day of September, 2016.

PUBLIC STAFF
Christopher J. Ayers
Executive Director

Electronically submitted
/s/ Antoinette R. Wike
Chief Counsel

4326 Mail Service Center
Raleigh, North Carolina 27699-4300
Telephone: (919) 733-6110
Email: antoinette.wike@psncuc.nc.gov

CERTIFICATE OF SERVICE

I certify that I have served a copy of the foregoing INITIAL COMMENTS OF THE PUBLIC STAFF on all parties of record in accordance with Commission Rule R1-39, by United States mail, postage prepaid, first class; by hand delivery; or by means of facsimile or electronic delivery upon agreement of the receiving party.

This the 16th day of September, 2016.

/s/ Antoinette R. Wike