BEFORE THE
TENNESSEE REGULATORY AUTHORITY

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IN RE: PETITION OF THE CONSUMER ADVOCATE DIVISION TO OPEN AN INVESTIGATION TO DETERMINE WHETHER ATMOS ENEGY CORP. SHOULD BE REQUIRED BY THE TENNESSEE REGULATORY AUTHORITY TO APPEAR AND SHOW CAUSE THAT ATMOS ENERGY CORP. IS NOT OVEREARNING IN VIOLATION OF TENNESSEE LAW AND THAT IT IS CHARGING RATES THAT ARE JUST AND REASONABLE

DOCKET 05-00258

****

REBUTTAL TESTIMONY

OF

DAVID FOSTER

****

AUGUST 18, 2006

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my rebuttal testimony is to affirm that the twelve (12) months ending September 30, 2006 is the appropriate attrition period on which rates should be based in this proceeding. I also provide an analysis comparing the seven (7) year historical trend of Atmos' actual operation and maintenance expenses ("O&M") and margin (revenues less gas costs) with both the results presented in pre-filed testimony by Atmos and the CAPD.

Q. What is the basis to consider for choosing an appropriate attrition period?

A. The Tennessee Regulatory Authority ("TRA") is responsible for setting rates that will allow a utility the opportunity to earn a fair and reasonable return. To accomplish this, the TRA chooses an attrition period that it believes properly reflects the company's earnings for the period in which the new rates will be in effect. Based upon past decisions of The Tennessee Public Service Commission ("TPSC") and supporting court decisions, the TRA has broad discretion in choosing an attrition period; it can choose past, current, future or a combination of periods on which to establish rates.

Q. Have you provided a copy of TPSC orders and court decisions that support your position that the Authority can use the twelve months ending September 30, 2006 as the attrition period?

A. Yes. Attached to my testimony are copies of two TPSC orders and an order issued by the Tennessee Supreme Court. In its Order issued on January 18, 1984 in Docket No. U-83-7248 (*Petition of South Central Bell Telephone to Change and Increase Certain Rates and Charges for Intrastate Telephone Service*), the TPSC set forth a comprehensive discussion regarding test and attrition periods as they relate to the establishment of rates.

Within this discussion, the TPSC also references a Tennessee Supreme Court Order relative to the TPSC's discretion for choosing a period on which to establish rates. Page five (5) of this TPSC Order provides in part:

> There are generally two types of test periods that are accepted in rate-making proceedings: an historical test period, which looks at a twelve month period in the recent past, and a forecasted test period, which attempts to predict revenues and expenses during the year to come.
>
> The Commission in most cases has used an historical test period rather than a forecast because **"prophecy however, honest, is generally a poor substitute for experience."** Southern Bell Telephone and Telegram Co. v. Tenn. Public Service Commission, 304 S.W. 2d 640 (1957), quoting from West Ohio Gas Co. v. Ohio Public Utilities Commission, 294 U.S. 79 (1935). Regardless of the type of test period chosen, however, **the ultimate goal of regulation is to select a period of time which properly reflect the representative relationships between revenues, expenses, and rate base expected to prevail during the period in which the new rates will be in effect.** As the Tennessee Supreme Court said in an unpublished opinion and order denying certiorari in Tenn. Public Service Commission v. South Central Bell, 579 S.W. 2d 429 (Tenn. App. 1979) cert. cen.:

> (I)t rests within the sound discretion of the Commission to use an historical test period, a forecast period, or a combination of these where necessary or any other accepted method of rate making necessary to give a fair rate of return – the ultimate goal being to assure efficient service to the consumer and a fair return on its investment to the company. **(emphasis added)**

The complete Supreme Court Order referenced above is attached.

Additionally, the TPSC stated on page six (6) of its order issued on August 20, 1993 in Docket Nos. 92-13527 (*Earnings Investigation of South Central Bell Telephone Company, 1993-1995*) and 93-00311 (*Petition of BellSouth Telecommunications, Inc., D/B/A South Central Bell Telephone Company for Conditional Election of Regulation Pursuant to Chapter 1220-4-2-.5 of the Tennessee Public Service Commission's Rules and Regulations*) that:

> We are satisfied that the law allows the Commission the discretion to use a forecast test period, a historical test period, or any other accepted method to determine a fair rate of return.

Q. Please explain the results of the analysis comparing the seven (7) year historical trend of Atmos' actual O&M expenses and margin with the results presented in pre-filed testimony by Atmos and the CAPD.

A. Chart A shows Atmos' actual earned margin for the twelve (12) months ended September 30, 1999 through September 30, 2005. Although there have been increases and decreases

in annual margins, the historical trend line on Chart A shows the average actual growth in margin. Chart A also shows the extended trend line through September 30, 2007. The margins identified in pre-filed testimony by the CAPD and Atmos are then plotted on Chart A relative to the trend line. Chart A demonstrates that the CAPD's projected margin of approximately $54.5 million for the twelve (12) months ending September 30, 2006 tracks slightly above the trend line, while the Company's forecasted margin of approximately $52.1 million for the twelve (12) months ending September 30, 2007 is well below the trend line.

Q. Please continue.

A. Chart B shows Atmos' O&M expenses for the twelve (12) months ended September 30, 1999 through September 30, 2005. Although there have been increases and decreases in annual O&M expenses, the historical trend line on Chart B shows the average actual growth in margin. Chart B also shows the extended trend line through September 30, 2007. The O&M expenses identified in pre-filed testimony by the CAPD and Atmos are then plotted on Chart B relative to the trend line. Chart B demonstrates that the CAPD's projected O&M expenses of approximately $13.4 million for the twelve months ending September 30, 2006 closely track the trend line; the CAPD actually projects slightly more O&M expenses for Atmos than the historical trend yields. Atmos' forecasted O&M expenses of approximately $15.4 million for the period ending September 30, 2007, however, are markedly above the trend line.

Q. What attrition period should the TRA adopt in this particular proceeding?

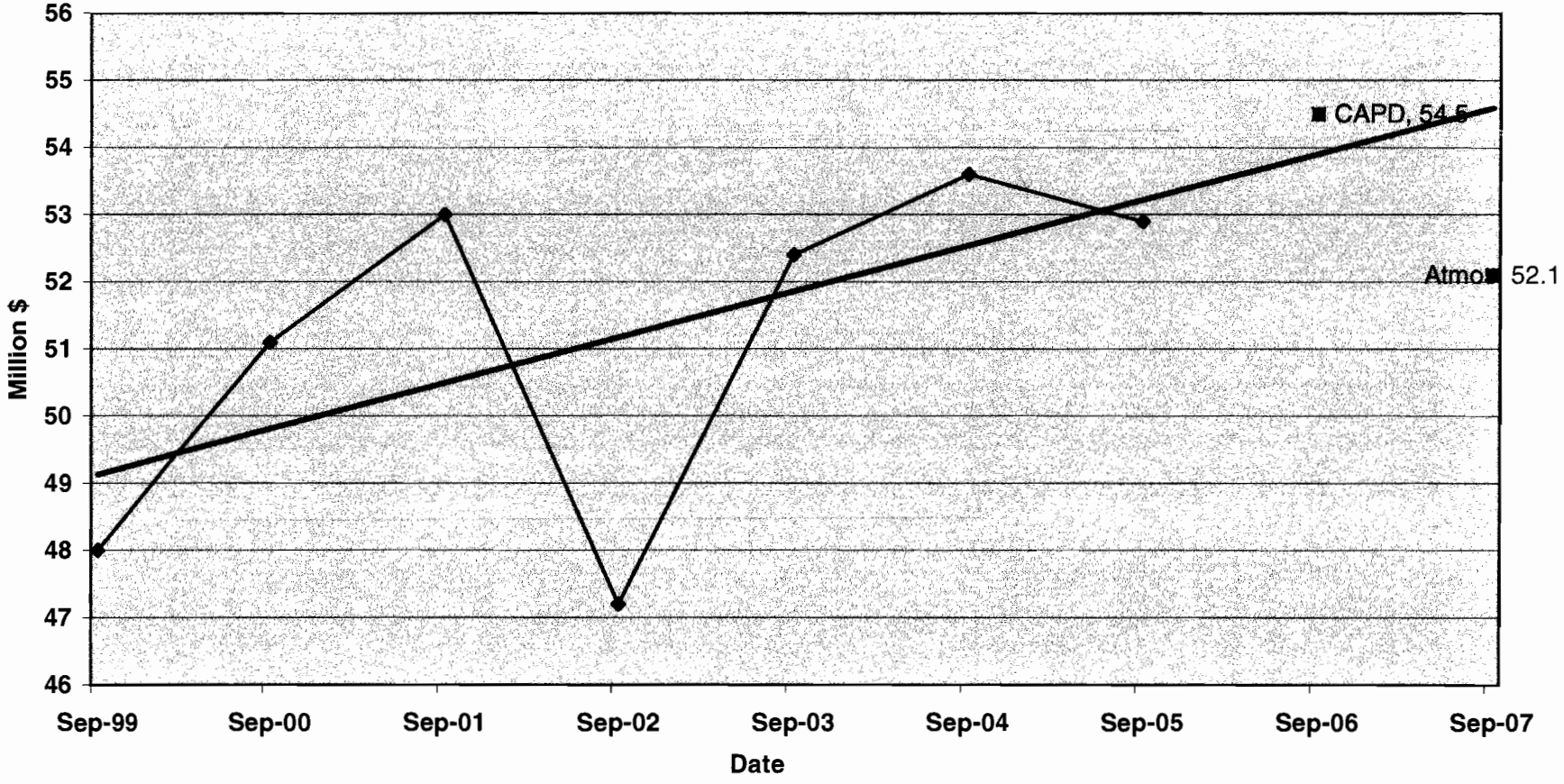
A. The twelve (12) months ending September 30, 2006.

Q. Please explain.

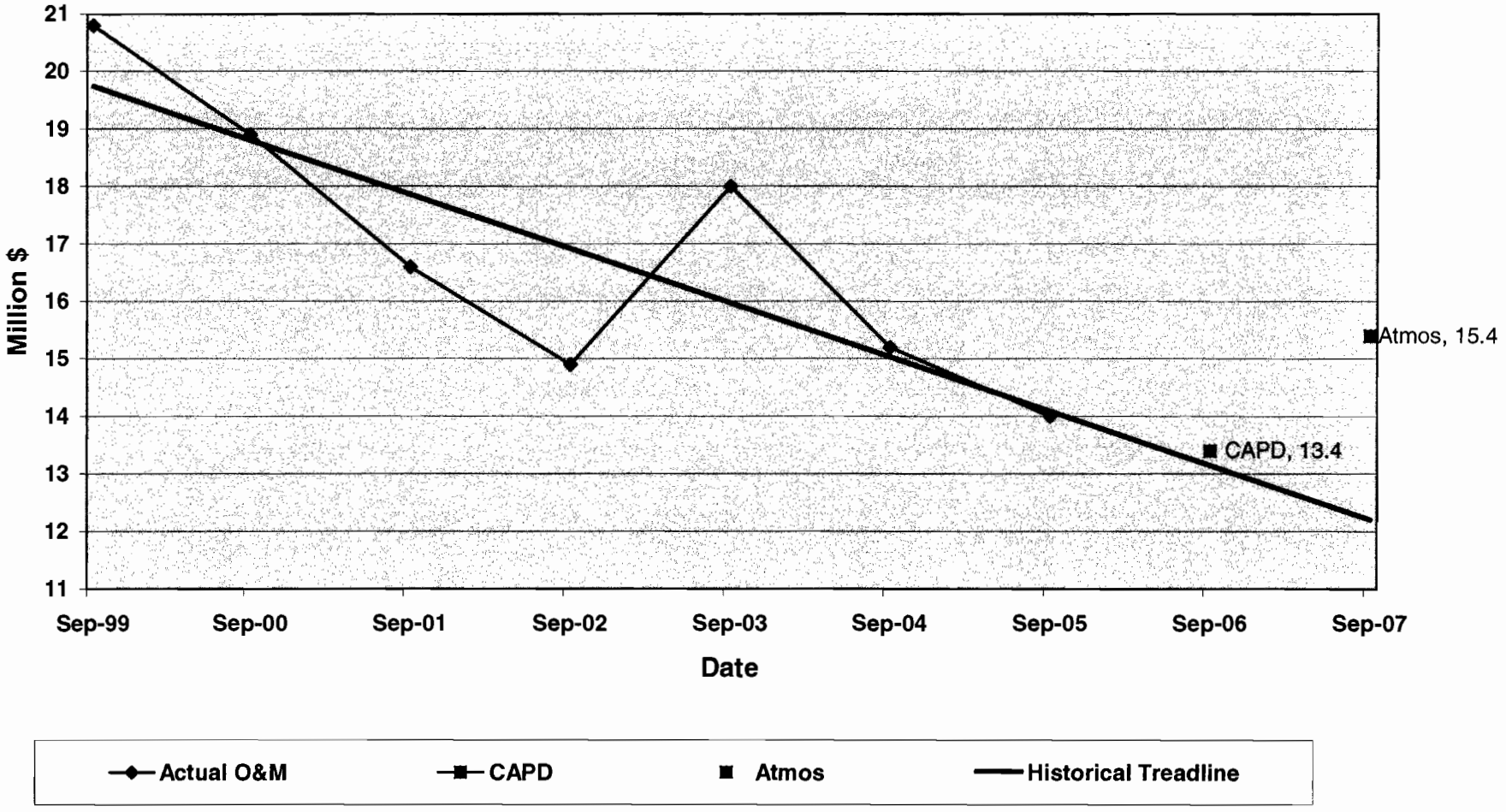
A. As stated previously, the TRA must choose an attrition period that it believes properly reflects the company's earnings for the period in which the new rates will be in effect. As demonstrated on the attached charts, the margin and O&M expenses set forth in the CAPD direct testimony closely track the historical trend line derived from actual results. Atmos' forecasted amounts through September 30, 2007, however, do not track closely with the trend line. I am not saying that conditions do not change and that these amounts do not fluctuate, I am simply saying that from a historical perspective, the CAPD September 30, 2006 forecast is more in line with trended results – results that I believe fairly represent the earnings level of Atmos. In sum, the TRA should choose results that best reflect the earnings of Atmos during the time period for which rates are set. Based on actual historical results, together with the adjustments made by the CAPD, the CAPD net operating income calculations fairly represent the level of earnings that Atmos will achieve in the future. Accordingly, the TRA should adopt the CAPD net operating income calculations for the twelve (12) months ending September 30, 2006 for establishing rates.

Atmos Margin

Chart A



Atmos O&M Expenses **Chart B**



BEFORE THE TENNESSEE PUBLIC SERVICE COMMISSION

Nashville, Tennessee

IN RE: PETITION OF SOUTH CENTRAL BELL TELEPHONE COMPANY TO CHANGE AND INCREASE CERTAIN RATES AND CHARGES FOR INTRASTATE TELEPHONE SERVICE

DOCKET NO. U-83-7248

JAN 1 3 1984

ORDER

This matter is before the Tennessee Public Service Commission upon the petition filed July 8, 1983 by South Central Bell Telephone Company (hereinafter referred to as Bell, SCB or the Company), wherein the Company requested authority to increase its existing rates and charges for intrastate telephone service to produce additional annual revenue of approximately $280 million dollars. The Company also filed a revised schedule of intrastate tariffs designed to produce the requested increase.

Pursuant to T.C.A. 65-5-203, the Commission suspended the proposed tariffs and set the petition for hearing.

Chairman Keith Bissell, Commissioner Jane Eskind and Commissioner Frank Cochran conducted hearings on the petition December 5, 6, 7, 8, 9, and 16, 1983, in Nashville, Tennessee, at which time the following appearances were entered:

APPEARANCES:

Mr. Raymond Whiteaker, General Counsel, South Central Bell Telephone Company, P. O. Box 410, 318 Green Hills Office Building, Nashville, Tennessee 37215, appearing on behalf of Petitioner, South Central Bell Telephone Company.

Mr. Mark D. Hallenbeck, Counsel, South Central Bell Telephone Company, P. O. Box 4771, 600 North 19th Street, Birmingham, Alabama 35201, appearing on behalf of Petitioner, South Central Bell Telephone Company.

Mr. T. G. Pappas, Attorney, 2700 First American Center, Nashville, Tennessee 37238, appearing on behalf of the Petitioner, South Central Bell Telephone Company.

Mr. Henry Walker, General Counsel, and Mr. Don Scholes, Assistant General Counsel, Tennessee Public Service Commission, C-1 102 Cordell Hull Building, Nashville, Tennessee 37219, appearing on behalf of the Commission Staff.

Ms. Susan Fengell, Attorney, LSUET, 311 West Walnut Street, Johnson City, Tennessee 37601, appearing on behalf of Intervenors, Low-Income Telephone Users.

Mr. William Allen, Attorney, P. O. Box =3358, Oak Ridge, Tennessee 37831, appearing on behalf of Intervenors, Low-Income Telephone Users.

Mr. Jerry Scanlon, Attorney, West Tennessee Legal Services, Jackson, Tennessee, appearing on behalf of Intervenors, Low-Income Telephone Users.

Mr. John W. Kelley, Attorney, 23rd Floor Life and Casualty Tower, Nashville, Tennessee 37219, appearing on behalf of Intervenor, United Inter-Mountain Telephone Company.

Mr. Val Sanford, Attorney, and Ms. Jean Nelson, Attorney, P. O. Box =2757, Nashville, Tennessee 37219, appearing on behalf of AT&T Communications, Inc. of the South Central States, Intervenor.

Mr. Gene V. Cocker, Attorney, 1200 Peachtree Street, N. E., Atlanta, Georgia 30357, appearing on behalf of Intervenor, AT&T Communications, Inc. of the South Central States.

Mr. Lon P. MacFarland, Attorney, P. O. Box =1121, Columbia, Tennessee 38401, appearing on behalf of Intervenor, General Telephone Company of the Southeast.

Mr. Dan H. Elrod, Attorney, and Mr. Edward C. Blank, II, Attorney, 26th Floor Life & Casualty Tower, Nashville, Tennessee 37219, appearing on behalf of the State of Tennessee, and Tennessee Association of Radio-Telephone Utilities, Intervenors.

At the hearings, South Central Bell presented the following witnesses:

Mr. J. D. Matheson, Vice-President-Revenue Requirements; Mr. John E. Ebbert, Operations Staff Manager; Mr. E. C. Roberts, Operations Staff Manager; Mr. D. M. Ballard, Assistant Chief Accountant; Mr. E. W. Parish, Jr., Operations Manager; and Mr. James L. Johnson, Vice-President of Tennessee Operations for South Central Bell Telephone Company. The Company also presented the testimony of Mr. J. W. Glass, Operations Manager-Executive Support of the BellSouth Corporation; Mr. Joseph M. Robbins, Division Manager of the Central Services Organization; Mr. David L. Laurent, Jr., Econometrician for BellSouth Services; Mr. Bosworth M. Todd, President of Todd Investment Advisors; Mr. Cornelius S. Prior, Jr., Vice-President for Kidder-Peabody and Co.; and Dr. Eugene F. Brigham, Professor of Finance at the University of Florida.

The Staff presented the testimony and exhibits of Dr. Fred Westfield, Professor of Economics at Vanderbilt University; Mr. Archie Hickerson, Assistant Director of Accounting; and Staff Financial Analysts Mike Gaines, Ronald Sanderson, Robyn Yazdian, and Roger Knight.

AT&T Communications of the South Central States presented the testimony of Mr. Roy A. Billinghurst, External Affairs Division Manager with the Southern Region of AT&T Communications. The Tennessee Association of Radio-Telephone Utilities presented the testimony of Mr. John F. Orman, Jr., Manager of Cellular Planning for the Mobile Communications Corporation of America.

Low Income Telephone Users presented the testimony of Dr. Michael H. Miller, Associate Professor of Economics at Vanderbilt University; Mr. Fred J. Kelsey, regulatory consultant and former public utilities specialist for the Federal Communications Commission; Dr. Lee Richardson, Professor of Marketing at the University of Baltimore; Dr. Robert Leger, Chairman of the Department of Sociology at East Tennessee State University; and Ms. Rozella Peebles, a low income subscriber of South Central Bell.

At the public hearing on December 7, 1983, thirty-two public witnesses including Representatives Martin Sir and Harold Love presented testimony. Petitions protesting the proposed increase were presented to the Commission.

Mr. Wil Cooley, Attorney for the Department of Defense (DOD) and the other Federal Executive Agencies, was unable to appear at the hearing. With the consent of all parties, however, the exhibits and testimony of Dr. Charlie A. McCormick, testifying on behalf of DOD were entered into the record. The testimony of Louis Corning, Vice-President-Administration of United Inter-Mountain Telephone Company, was also entered by stipulation. Although granted leave to intervene in this case on August 17, 1983, Tennesseans for Affordable Telephone Rates did not appear at the rate hearings and no explanation for their absence has been provided.

The Commission considered the petition at a regularly scheduled executive session on January 3, 1984, and again on January 4. On the

Sth the Commission denied the petition for a $280 million rate increase but determined, by a two to one vote, that an increase of approximately $39.3 million in annual revenues would provide Bell a fair and reasonable rate of return. The Commission directed the Company to file revised tariffs which would produce the indicated additional revenue.

On January 6, 1984, the Company filed its revised tariffs, which we approved in a brief Order issued that same day. In that Order, we also said that the Commission would issue a detailed statement of our findings of fact and conclusions of law in a second Order and Memorandum Opinion no later than January 18, 1984. Counsel for the Company and the Commission Staff stipulated that this procedure and schedule would comply with the six-month time limit set forth in T.C.A. 65-5-203 (b) and also that, for purposes of administrative and judicial review, the Memorandum Opinion would be considered as the Commission's final Order in this proceeding.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

The Commission's statutory duty in the proceeding is to fix just and reasonable rates for the Company as provided by T.C.A. 65-5-203. In so doing, we must take into account the safety, adequacy, and efficiency or lack thereof to the service or services furnished by the utility, and it is our duty to approve all or any portion of a proposed increase in rates if we are satisfied that the increase is just and reasonable.

In this case, we will follow our standard practice of choosing a test period and then making findings of fact in regard to four major areas (1) the size of the Company's rate base; (2) total revenues received during the test period; (3) total expenses during the same period; and (4) the rate of return which the utility should be allowed to earn.

Once these issues are determined, we will then calculate the amount of the revenue award in this case. Finally, we will consider questions of rate design and issues raised by some of the intervenors in this proceeding.

I. TEST PERIOD

Test period is a term peculiar to regulation. It refers to a period of time, usually twelve months, during which the Commission examines the Company's revenues and expenses under existing rates and calculates, for that twelve month period, the Company's rate of return on its rate base investment.

There are generally two types of test periods that are accepted in rate-making proceedings: an historical test period, which looks at a twelve month period in the recent past, and a forecasted test period, which attempts to predict revenues and expenses during the year to come.

The Commission in most cases has used an historic test period rather than a forecast because "prophecy, however honest, is generally a poor substitute for experience." Southern Bell Telephone and Telegraph Co. v. Tenn. Public Service Commission, 304 S.W. 2d 840 (1957), quoting from West Ohio Gas Co. v. Ohio Public Utilities Commission, 294 U.S. 79 (1935). Regardless of the type of test period chosen, however, the ultimate goal of regulation is to select a period of time which will properly reflect the representative relationships between revenues, expenses, and rate base expected to prevail during the period in which the new rates will be in effect. As the Tennessee Supreme Court said in an unpublished opinion and order denying certiorari in Tenn. Public Service Commission v. South Central Bell, 579 S.W. 2d 429 (Tenn. App. 1979) cert. den.:

> (I)t rests within the sound discretion of the Commission to use an historical test period, a forecast period, or a combination of these where necessary or any other accepted method of rate making necessary to give a fair rate of return--the ultimate goal being to assure efficient service to the consumer and a fair return on its investment to the company.

The Company has proposed a forecasted test period-the calendar year 1984-for which it has filed its budget of operations. One forecast, prepared in May, 1983, was filed with the petition in July. A second, updated forecast, prepared in September, was also filed with the Commission and it is the latter view of 1984 which Bell has asked us to adopt in this proceeding.

Because of the changes resulting from divestiture of South Central Bell from its parent, American Telephone & Telegraph, and its effects upon the Company's operations in 1984, the Commission staff also used the 1984 calendar year as the test period in this case. In his direct testimony, staff witness Hickerson explained:

> The staff used a forecast of operations for calendar year 1984, consistent with the test period proposed by the Company. As a result of the reorganization of the Company and the industry as a whole, it is our opinion that the use of this forecast will produce a reasonable basis for the Commission to evaluate the Company's earnings under current rates and to determine the revenue deficiency that might exist.

We agree with Mr. Hickerson's analysis.

Two parties in this proceeding, the State of Tennessee and the Low Income Telephone Users (LITU), have questioned the reliability of the forecasted period in light of the immense changes occuring in the Bell system and the difficulty in predicting the Company's expenses, revenues, and rate base following divestiture. Neither party, however, presented evidence as to the Company's rate base, expenses, and revenues during an historic test period. Furthermore, we cannot close our eyes to the unusual circumstances presented by the reorganization of the Bell system. A forecasted test period is not generally as relaible as an historic period to measure a utility's earnings. In the present case, however, the rate base, revenues, and expenses of South Central Bell during the past twelve months will be affected dramatically both by court-ordered divestiture and regulatory changes mandated by the Federal Communications Commission. "At such times, an honest and intelligent forecast of probable future values, made upon the view of all relevant circumstances is the only organ at hand and hence the only one to be employed in order to make a fair hearing." Southern Bell, supra. Where feasible, we have used historic expenses and revenues to guide us in forecasting those figures in 1984. Furthermore, our use of a forecasted test period in this case should not be interpreted as a change in the Commission's long standing policy of preferring an historic test period for rate making purposes. On the basis of the record before us, however, and the recommendation of the Commission Staff, we find that a forecast of operations for the calendar year 1984 is the appropriate test period to

adopt in this case.

II. COMMISSION STANDARD ADJUSTMENTS

Before discussing the appropriate expenses, revenues, and rate base to use in this case, we will first dispose of certain Staff adjustments to the figures proposed by the Company. These adjustments, collectively referred to as "Commission Standard Adjustments," have been proposed in accordance with prior Commission decisions in cases involving South Central Bell. In the Company's last rate filing, Docket U-82-7161, Bell agreed to all Commission Standard Adjustments (for that case only); and in the present filing, the Company did not present any rebuttal evidence nor cross-examine Staff witnesses about these accounting changes.

In light of the unrefuted adjustments made by the Staff and the Commission's established precedents on each of these issues, we again affirm the use of those adjustments and adopt them in this case. Furthermore, we direct the Company in its next rate petition to include these adjustments in its original filing as an alternative to the Company's unadjusted figures. This will save time and avoid unnecessary discovery procedures for both the Company and the Staff.

The Commission therefore adopts the following standard adjustments to the Company's income statement and rate base.

A. Employee Concessions

Bell managers receive local telephone service free of charge. Non-management employees receive local service at a forty per cent discount. The purpose of this adjustment is to impute revenue to the Company as if the management employees paid the same rate for local service as the non-management employees. This adjustment adds $111,232 to local service revenue to bring the total to $453,674,000. Both employee groups also receive discounts on intra-LATA toll calls but, since we do not know at this time how many such calls the average employee will make, this benefit cannot be quantified and no adjustment can be made in this case. The Company is directed in its next rate filing to provide sufficient information for the Commission to quantify the revenue impact of the toll discounts provided to both management and non-management employees.

The Low Income Telephone Users have suggested that we eliminate all employee concessions for both local and toll service. On the basis of testimony by Company Vice President Johnson, we find that these concessions are considered by Bell and its employees as part of the employees' total benefit package. While management employees do not bargain collectively for their compensation, we believe it appropriate that they should be treated equally to non-management employees for rate-making purposes.

B. Short-Term Interest During Construction

In a prior rate case, the Commission ordered Bell to keep separate records on interest capitalized during short-term construction projects so that the Commission could add it to interest capitalized on long-term projects. See Docket No. U-6936. The capitalization of interest during construction means that the capital cost of funds tied up in a construction project is added to the total cost of the project and recovered gradually as a depreciation expense after the project goes into service. This means that future customers, not present customers, will pay those costs at the time that they are receiving the benefits of the project. This logic applies both to long-term and short-term projects.

By capitalizing rather than expensing these interest costs, the Company's present interest expense is reduced. In accordance with standard accounting practice, this adjustment is made by increasing the Company's interest income.

C. Lobbying Expense Adjustment

The Staff deducted from Bell's proposed budget for 1984 certain expenses relating to lobbying activity. We believe that the first obligation of the Company's lobbyists is to benefit the Company, not necessarily the Company's customers. We maintain our policy that lobbying expenses should not be considered for ratemaking purposes.

The Low Income Telephone Users correctly point out that the Company's expenses in the lobbying account are limited to those lobbying activities defined by T.C.A. 3-6-102(11) and the Staff, while recommending that these expenses be disallowed, has not looked closely at what is included in this account nor considered whether the statutory definition of lobbying in the Tennessee Lobbyist Registration and Disclosure Act is appropriate as a definition of lobbying for ratemaking purposes.

Unfortunately, there is no basis in this record on which to determine whether or by what amount the Company may have under-reported its lobbying expense as LITU alleges. We request the Staff to consider this issue at the Company's next rate filing.

D. Accumulated Deferred Income Tax.

The Staff deducted from Bell's rate base the accumulated deferred tax account which represents non-investor supplied funds, tax payments that have been collected from the ratepayers but not yet paid to the government. The Company uses this customer-contributed capital to finance a portion of its investment.

We agree with the principle that the rate base should represent the investment financed by debt and equity investors, not the ratepayers. We, therefore, adopt the Staff recommendations that accumulated deferred income tax be deducted from the Company's rate base.

E. Unamortized Investment Tax Credit, Pre-1971.

This item represents the unamortized balance of investment tax credits generated under the 1962 tax act. It is non-investor supplied capital used to finance a portion of the Company's investment and, therefore, should be deducted in computing the Company's rate base. Company witness Ballard did not make this deduction. The Company, however, did reduce its revenue requirement so as to produce the same result as if the deduction had been made.

F. Unpaid for Materials and Supplies

The Staff has deducted the unpaid-for portion of the materials and supplies account from the rate base because this portion of the account will remain unpaid during the test period. In other words, the vendors who sell materials and supplies to the Company have become a source of capital to the Company. Since this capital is supplied by the vendor, rather than the Company's stockholders, the Company should not receive a return on this portion of its investment.

advertising expenses increased dramatically in that year over all previous levels. We have not questioned that expense but believe that it is a fair indication of Bell's advertising expenses in the post-divestiture period. The Company's actual expenses in 1983, presently well under the budget according to Staff testimony, reinforce our conclusion that Bell's forecasted, 1984 figures are inflated. Finally, while we agree that it is important to inform customers about changes in the Bell system, we agree with the Low Income Telephone Users that, "Much of the advertising surrounding divestiture is, in actuality, institutional advertising, the most highly disfavored of all advertising with respect to inclusion as an operating expense" (Post-hearing Brief, p. 18).

Witness Lee Richardson from the University of Baltimore provided further evidence that the Company's advertising budget should be reduced. Testifying on behalf of the Low Income Users, Professor Richardson discussed Bell's measured and message service options which he said were being actively promoted by SCB as a marketing device to enhance the Company's revenue stream. Saying that the widespread use of measured and message service would eventually drive up the cost of flat-rate service without any benefit to the ratepayers, Professor Richardson recommended that we order Bell to discontinue its promotional campaign until the Company can demonstrate that the service options are not being subsidized by subscribers of flat-rate service. The Low Income Users further suggest that we freeze at current levels the number of customers who subscribe to measured and message service.

We reject the proposal for a freeze. These are optional services that many customers now use at considerable cost savings. In the absence of any specific evidence that these services are actually priced below cost, we will not deprive other Tennesseans from taking advantage of the savings. We agree, however, that there are sufficient questions surrounding measured and message services to justify reducing Bell's 1984 advertising budget which includes $200,000 to promote these service options.

8. Refund of AT&T Pre-Operational Expense

Through the General Service and License Contract, South Central Bell and all AT&T subsidiaries paid AT&T for costs involved in the formation of a new AT&T subsidiary (originally named ABI) and in the development of customer premise equipment (CPE). Both the subsidiary and the equipment were subsequently deregulated by the Federal Communications Commission. In its Order of November 10, 1982, the FCC directed AT&T to reimburse South Central and the other Bell telephone subsidiaries for these payments. Subsequently, SCB reported to the Commission that it had received a refund from AT&T of $3,294,000.[1/]

The Order required that the refund be recorded in account 174, Other Deferred Credits and that the amount be "cleared from the books once rate making treatment has been afforded those amounts as parts of the reimbursement process or where a Commission has decided no reimbursement is required." In addition the FCC ordered, "In conjunction with the first rate making proceeding following the reimbursement to regulated affiliates, the appropriate BOC shall present the allocated pre-operational expenses again to each state commission for rate making scrutiny." Paragraph 70 of the Order stated, "By requiring AT&T to reflect reimbursement amounts as liabilities on the BOC's and long lines books and requiring special reporting to State Commissions, an adequate mechanism has been established to assure that actual and accurate reimbursement will occur." (Emphasis added.)

There is no mistake that the intent of the FCC was to reimburse the ratepayer for the funds that have been collected through the customers' bills to pay for projects which will only benefit AT&T.

1/ Subsequent to the close of the hearings the Company filed with the Executive Director a supplemental report identifying an additional refund of pre-operational expenses of $1,447,112. This refund will be considered along with the $3,294,011 included as an expense reduction in the Staff's exhibit. This reduces the General Service and License expense on Schedule 4 of the Staff's exhibit from $7,720,000 to $6,273,000.

The Staff is in agreement with the FCC and proposes that reimbursed funds be paid back to the customers in the form of reduced rates. In order to accomplish this objective the Staff has proposed that the entire refund be amortized and credited to the General Service and Licenses expense in 1984.

Company witness Johnson explained that Bell would "like to be able to keep the $3.3 million dollars since we have ups and downs in expenses and revenue through the years." He cited as an example a retroactive $2.6 million increase in the Company's gross receipts tax. He further explained that the Company has not earned its authorized rate of return in 1983 and that the Commission should therefore allow the Company to keep the entire refund.

We recognize that fluctuations in revenues and expenses occur and that unexpected events such as the increase in the gross receipts tax have an impact on the utility's earnings. Such events, however, do not justify the Company's proposal to retain funds that were wrongly collected from the ratepayers to pay for costs related to non-utility operations.

In arguing that it be allowed to keep the refund in light of its current rate of return, the Company has implied that there is some relationship between the refund and the 1983 accounting period. In fact, none of the amount refunded relates to 1983; all of the money was collected from the ratepayers between 1979 and 1982, and in three of those four years, Bell earned more than its authorized rate of return, according to Staff figures. The only factor that links the refund to the 1983 accounting period is the accidental timing of the FCC's investigation and Order. Had the FCC ordered AT&T to delay the refund until 1984, we wonder if the Company would propose to recognize the refund as a revenue or as an expense reduction in the 1984 budget.

We agree with the Staff, the Low Income Users, and the FCC that these funds represent costs improperly collected from the ratepayers who are entitled to be reimbursed. The amortization of the refund over the twelve months beginning January 1, 1984 will provide an equitable method of implementing the refund.

C. Yellow Page Revenues

The Company included in its original prefiled exhibits an estimate of Yellow Page revenues and expenses calculated in accordance with the accounting procedures traditionally used by this Commission in setting rates for South Central Bell.

Two months later, however, in its revised budget figures for 1984, the Company changed its position because of the creation of a new BellSouth subsidiary which will publish all Yellow Pages for South Central Bell and Southern Bell and pay each company a license fee.

The effect of this arrangement in the present case is to increase the rates of Tennessee customers by more than $3 million. Bell's plan will reduce substantially South Central Bell's profits from Yellow Page revenues, profits which help keep down the costs of basic telephone services. Under Bell's proposal, a significant portion of those profits will go to BellSouth's new, unregulated subsidiary rather than to the Bell operating companies.

SCB argues that the consolidation of all Yellow Page business in one subsidiary "should be more efficient and economical" than if each operating company were to handle its own Yellow Pages.

At some time in the future, perhaps, the Company can show us that these savings will increase the amount of Yellow Page profits paid to South Central Bell. Until that time, however, we will not accept Bell's attempt to siphon off part of these revenues which are directly generated from the customer lists developed and maintained by the operating companies. In future cases, we will continue to monitor this situation closely, keeping in mind the requirement of the Modified Final Judgment, a requirement which AT&T opposed, that the Yellow Page business remain with the Bell operating companies and under the jurisdiction of state regulatory commissions so that the profits from that business could be used to keep rates down.

The Staff's estimate of Yellow Page profits was prepared in accordance with the procedure used by the Commission in the past and with

the exhibits originally filed by the Company in this case. In doing so the Staff recognized Yellow Page revenue, the related expenses, and investment as part of SCB's regulated operations. This approach permits full recognition of directory revenues and expenses and provides the Company an opportunity to earn a fair return on the investment related to the directory operations. To recognize the full benefit of Yellow Page profits to local rates, the Commission adopts the Staff's treatment of Yellow Page revenues and expenses.[2/]

D. Toll Revenues

In an earlier Order issued in this proceeding on December 16, 1983, we stated that the parties had agreed upon the dollar amount of access charges to be collected from AT&T by South Central Bell. Counsel for Bell stated that this amount, approximately $61.5 million, would fully reimburse SCB for the loss of inter-LATA toll revenue following divestiture. In light of this agreement, there is apparently no longer a dispute concerning the proper amount of Bell's toll revenue during the test period. The calculation of this amount, $202,606,000, is shown in Appendix A (attached).

E. Gross Receipts Taxes

Two other issues, gross receipts taxes and Bell's proposed payments to the Central Services Organization (CSO), are not raised in the Company's post-hearing brief and proposed findings. We assume that these matters are no longer in dispute. Since they were discussed at the hearings, however, we will briefly explain our findings on both issues.

2/ We also reject Bell's proposal because the Company did not correctly transfer to the new subsidiary all of SCB's Yellow Page expenses. In determining the costs to be transferred from SCB to the new subsidiary, Bell included an amount to provide the new subsidiary a return on its investment in the prepaid directory expense account. This transfer is proper if one assumes that this investment is also transferred from SCB to the new subsidiary. However, the Company made no adjustment to show this reduction in its rate base and therefore failed to transfer to the subsidiary all of the costs related to directory operations. As a result, South Central Bell's projected cost of operations, as reported in the September forecast, is overstated.

At the hearing, Company witness Parrish proposed to increase the budgeted GS&L expense because of additional CSO expenses which would be charged to South Central Bell in Tennessee.

He agreed to furnish after the hearing additional information on how each of the CSO projects would benefit the ratepayers of Tennessee and also a breakdown of the costs involved in each of the projects.

The Commission has reviewed this information and, in our opinion, it is not sufficient to justify the increases in the CSO budgeted expense proposed by Mr. Parrish. We therefore find that the expense shown on Exhibit 28, Schedule 26, should be used as a basis for setting rates in this case. That expense is based on Mr. Parrish's original estimate of the CSO expense as corrected by the Staff. It also includes the FCC ordered refund discussed previously.

G. Low Income User Issues

1. Charitable Contributions

The Low Income Users ask us to reconsider our past policy of recognizing that reasonable charitable contributions by South Central Bell are legitimate, business expenses and may properly be charged to the ratepayers. Our view, which is apparently shared by the majority of state regulatory commissions, is that utility "good will" is a valuable asset, though admittedly difficult to quantify, which ultimately benefits ratepayers. See A.J. Priest, Principles of Public Utility Regulation (1969), Vol. L, p. 87. Utilities, like all major corporations, are expected to contribute their fair share to charitable activities in the community. As long as these contributions are reasonable (there is no evidence in this record to indicate otherwise), we will recognize Bell's charitable contributions and concessions as just and reasonable business expenses.

2. Government Concessions

The Low Income Users also request us to disallow Company concessions to various local governments and agencies. We doubt that we

have the legal authority to take this action in regard to municipal franchises previously approved by this Commission and now in effect. The record indicates, however, that SCB lost $619,000 for the twelve months ended March 31, 1983, on concessions to governmental agencies granted in compliance with various municipal franchises. The revenue loss for 1984 is estimated to be $552,000. To deal with this growing problem, the Staff recommends, and we agree, that from this date forward, the Commission will not approve local franchises that provide for government concessions. Our decision is in concert with Mr. Johnson's testimony that SCB is opposed to franchises that require concessions. The present system is highly discriminatory. Some cities enjoy concessions while others do not. Our policy will help provide uniformity throughout the State in regard to government concessions.

3. Tax Issues

In its post-hearing brief LITU proposed several adjustments to federal income taxes without having presented a witness to set forth the benefits of the proposals. The proposals included the immediate flow through of deferred taxes related to:

(1) Vacation accruals; (2) Capitalized overheads relating to construction work in progress; (3) Accelerated depreciation at rates in excess of 46%; and (4) Pre-1971 investment tax credits.

LITU based its motion to immediately flow through the tax benefits resulting from expensing vacations when accrued for tax purposes on page 15 of its brief on information supplied in late filed Exhibit 13, which was filed after clarifying cross-examination of Company witness Ballard about SCB's tax accounting relating to the four items. The response points out that the $5.5 million deferral deducted from rate base reduced the Company's gross revenue requirements by $1.4 million in 1984. Assuming the balance stayed at the forecast level, reductions in revenue requirements of similar levels would continue in the future, depending, of course, on the rate of return granted. The reduction in rate base is consistent with the proposal on page 5 of LITU's brief but conflicts with

the proposed flow through advocated on page 15 of the brief.

The normalization procedure followed by the Company has been approved by the FCC and has been recognized by the Commission in past cases. LITU has proposed conflicting treatment of this item and in our opinion has not presented sufficient evidence or arguments to justify changing the procedure followed in the past.

LITU next proposed an immediate flow through of prior deferrals relating to the capitalization of relief and pensions and payroll taxes on the books of SCB and the expensing of them on its tax returns. As properly pointed out on page 2 of the Company's responses in Exhibit 13, no deferred taxes exist as the differences in book and tax treatment are permanent. For book purposes relief and pensions, and payroll taxes relating to the salaries capitalized on construction projects are also capitalized. For federal tax purposes these overheads are taken as tax deductions in the year paid.

As the staff has pointed out on many occasions and as this Commission has recognized in several recent cases involving United Inter-Mountain Telephone Company, South Central Bell does flow through the effects of these capitalized overheads as do other telephone utilities. The staff has opposed the normalization of the tax effects of these items and this Commission has agreed. Since the Company is doing what LITU requested us to order them to do, this issue is moot.

LITU also proposed, without quantification or witness on the subject, that this Commission order the Company to immediately refund federal income taxes deferred in previous years when the tax rate was greater than the current 46%. During cross examination, Company witness Ballard pointed out that for a number of years the Bell System had followed the Average Rate Method to flow back these tax deferrals as provided by the Internal Revenue Code, which is consistent with the rate making treatment afforded this item in the past. Again LITU has proposed conflicting treatment in advocating the immediate refund while deducting the deferral from rate base; we do not believe that the intervenor has fully analyzed all the ramifications of the proposal or offered sufficient evidence to change the procedure used in past cases.

The final proposal of LITU at page 17 of its brief was to immediately flow through the pre-1971 investment tax credits of $927,000 proposed as a rate base deduction by the staff and supported by LITU on page 6 of its brief. Again LITU can't have it both ways as proposed. Several years ago this Commission gave the utilities an option as to the treatment of investment tax credit. SCS chose the normalization option. IITU's proposal would have a one time immediate effect while the reduction of federal income tax expense by its amortization has more stable long range benefits. In summary LITU has not presented convincing arguments for us to change our position and has in fact proposed conflicting treatment of the same item.

Cost of Service:

In the hearing and in their brief LITU raised issues concerning the Company's failure to provide detailed cost data concerning various types of telephone service. Although the Company provided its Embedded Direct Analysis (EDA), we believe that this subject warrants additional investigation. Therefore, we direct the Company to conduct a study to select an appropriate methodology which will then be applied to determine the costs of the various types of services provided by the Company, including specifically business, residential, and local measured and message service. The study should specify the service identifications, study methodology, and the uses and limitations of the results. The study should identify the source of all figures and variables used in study so that the data provided can be traced to the Company's books and accounting records.

ECS Study

The study should be submitted to the Commission by June 1, 1984.

G. Cash Advanced Through Operations

Staff also deducted from the rate base cash advanced through operations, the amount of which was determined through the use of a lead-lag study. This figure represents the cash which Bell collects from its customers but has not yet paid to meet expenses. This is another source of non-investor supplied funds which have been used to finance a portion of the Company's investment and should be deducted from Bell's rate base.

H. Customer Deposits and Interest on Customer Deposits

The Staff has properly excluded customer deposits from the rate base because these deposits also represent non-investor supplied funds. In making this adjustment the Staff also recommended that interest paid by the Company on these deposits be considered an above-the-line expense. We will adopt the Staff's adjustment by decreasing net operating income to account for interest on customer deposits.

III. RATE BASE

Company witness Ballard testified that Bell's rate base for the test period would be $1,601,423,000. Staff witness Knight recommended a $1,296,215,000 rate base which reflected the Commission Standard Adjustments.

For the reasons explained above, we approve the use of the Commission Standard Adjustments and adopt the rate base recommended by Mr. Knight.

The Low Income Telephone Users suggested that we should make an additional adjustment to the rate base by deducting all plant under construction. We have consistently held, however, that investors whose capital is committed to construction programs are entitled to a return on that investment. In the long run, we believe this policy encourages new investment and promotes a healthy construction program to maintain and improve service. In the absence of any testimony to the contrary, we will permit the Company to include construction work in progress in the rate base.

The Commission therefore adopts the following rate base as appropriate for use in this case.

SOUTH CENTRAL BELL TELEPHONE COMPANY

TENNESSEE INTRASTATE

AVERAGE RATE BASE

1984 (000)

Line No.		
1.	Telephone Plant in Service	$1,935,663
2.	Telephone Plant Under Construction	32,564
3.	Property Held for Future Telephone Use	88
4.	Materials and Supplies	9,690
5.	Cash Requirements	2,795
6.	Total	$1,980,000
	Deductions	
7.	Depreciation Reserve	$ 417,944
8.	Accumulated Deferred Federal Income Tax	244,050
9.	Unamortized ITC-Pre-1971	927
10.	Unpaid for Materials and Supplies	1,599
11.	Cash Advanced Through Operations	13,565
12.	Customer Deposits	6,500
13.	Total Deductions	$684,585
14.	Rate Base	$1,296,215

IV. REVENUES AND EXPENSES

Although there are a number of differences between the Company's projected revenues and expenses for 1984 and the figures recommended by the Staff, the Company rebutted only two of the Staff's adjustments, the advertising budget for 1984 and the FCC-ordered refund of AT&T pre-operational expenses. In its post-hearing brief and proposed findings of

fact and law, the Company discussed those two issues and two others, revenues from Yellow Pages and from intrastate, inter-LATA toll service. The Low Income Users supported the Staff position on each of these four issues which we will now discuss.

A. Advertising Expense

The Staff recommended that the Company's advertising expense for 1984 be reduced from $5,742,000 to $4,291,000 because $986,000 of toll advertising will be transferred to AT&T and $1,089,000 in advertising for terminal equipment (transferred to AT&T) will be eliminated.

In arriving at the $4.3 figure for 1984, the Staff looked at Bell's actual advertising expense in 1982 ($6 million) and then reduced it by $2 million to account for the reduction in terminal equipment and toll advertising. The result was then increased to reflect the growth in the Consumer Price Index in 1983 and 1984.

Bell opposed the Staff's adjustment on the grounds that its advertising expenses in 1984 are necessary to inform customers of changes in the Bell system during the coming year. Bell argued that the loss of any of its advertising budget at this time will deprive customers of this information.

Staff witness Gaines replied that his method of forecasting Bell's advertising expense recognized the need for more informational advertising since the 1982 base period from which the 1984 budget was developed included a $.6 million increase in informational advertising over 1981. Mr. Gaines also said that he was making no recommendation as to the amount of the advertising budget which Bell should spend on customer information rather than promotional advertising. The Company may spend as much, or as little, of its budget on informational advertising as it feels is necessary.

We agree with Mr. Gaines' recommendation. This Commission has never attempted to tell SCB how to spend its advertising budget; we only require that the total expense be just and reasonable. Because of divestiture, which was announced on January 8, 1982, the Company's

The Court approved Plan of Reorganization for AT&T provides that "the amount of prepaid taxes associated with facilities or functions assigned to AT&T will be assigned to AT&T" (P.O.R. p. 135). As AT&T will take over inter-LATA toll and terminal equipment rental operations, the Staff's position is that AT&T should be required to reimburse SCB for all prepaid taxes associated with these operations. Staff witness Knight, therefore, recommended that SCB bill AT&T $2,470,000 for prepaid gross receipts taxes that relate to revenues from terminal equipment rentals and inter-LATA state toll generated in 1982.

In a letter dated December 21, 1983, to the Commission from the Tennessee Department of Revenue (late filed Exhibit 37), the Department states that the prepaid gross receipts tax relating to AT&T Communications is transferable to AT&T Communications. The Department letter also states, however, that AT&T Information Systems (ATTIS), a telephone equipment company, is not subject to the gross receipts tax. Bell argues that AT&T may therefore refuse, in violation of the POR, to reimburse Bell for taxes associated with the terminal equipment being transferred to ATTIS.

While the ruling of the Revenue Department satisfies part of SCB's concern, the Commission believes that the POR is controlling in this matter and that AT&T is obliged to abide by it. Therefore, the Commission adopts the Staff's level of gross receipts tax expense of $9,702,000 and directs SCB to seek reimbursement of the full $2,470,000 from AT&T and to take appropriate action, if necessary, to enforce the terms of the Plan of Reorganization.

F. CSO Budget

The Staff proposed adjustments to reduce the $12,060,000 General Services and Licenses expense budget to correct $1,050,000 in arithmetical errors which the Staff found in the Company's proposed Central Services Organization (CSO) budget for 1984. These corrections were not challenged by the Company.

V. FAIR RATE OF RETURN

A finding on fair rate of return is one of the most subjective determinations this Commission must make in arriving at a decision concerning the proper level of rates a company charges its customers. We make this determination in light of the controlling legal standards laid down by the United States Supreme Court in the landmark Bluefield and Hope cases. In Bluefield case, the Court stated:

> (A) public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional rights to profits such as are realized or anticipated in highly profitable or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility, and should be adequate, under efficient and economical management to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.

Bluefield Water Works and Improvement Company v. Public Service Commission of the State of West Virginia, 262 U.S. 679, 692-93 (1923).

Later in the Hope case, the Court refined these guidelines holding that: (FPC v. Hope Natural Gas, 320 U.S. 591, 603 (1944))

> "From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise so as to maintain its credit and to attract capital."

With these basic standards in mind, we will discuss some of the important considerations that were presented at the hearing on the subject of fair rate of return. We believe that the standards, as set out in these two decisions, point out an important fact: the setting of a fair rate of return is not an exact science. As the following discussion illustrates, a return that one informed person believes is fair and necessary to provide a comparable return enjoyed by other similar

enterprises and to attract necessary capital may not be the same return as another informed person might believe. Needless to say, our discussion is of necessity limited and cannot and will not be fully comprehensive of all relevant matters and components that go into the make-up of the determination of a fair rate of return.

Four witnesses presented direct testimony concerning the cost of capital for BellSouth. Three witnesses, Matheson, Todd, and Prior, testified on behalf of the Company. Todd and Prior, both investment counselors, said that based on the earnings of other corporations, they would not advise their clients to buy BellSouth stock unless they anticipated at least a 16% return. Mr. Matheson, who also testified that the return on BellSouth's common equity should be in the range of 16-18%, recommended that the Commission grant the Company an overall rate of return of 13.25% based on a debt-equity ratio of 45%, a 16% return on common equity and 9% as the cost of embedded debt.

Testifying on behalf of the Staff, Dr. Westfield recommended an overall return in the range of 10.8 to 11.7, based on an 8.8% cost of debt, a 12.6 to 14% cost of equity, and the same debt-equity ratio used by Mr. Matheson

After reviewing the extensive evidence in the record, which includes the rebuttal testimony of Professor Brigham and the surrebuttal testimony of Dr. Westfield, we find Dr. Westfield's analysis persuasive and adopt the mid-point of his recommended cost of equity. We believe that he underestimated the Company's cost of debt, however, and will adopt an 8.9% cost of debt, mid-way between Westfield and Matheson, for use in this case. Since there is no dispute on the appropriate capital structure, our findings on the costs of equity and debt result in an overall rate-of-return of 11.3% for South Central Bell's investment in intrastate operations for Tennessee.

Dr. Westfield's estimate of the cost of equity was calculated using the Discounted Cash Flow (DCF) formula which both he and this Commission have consistently relied upon in determining the cost of equity capital. Using information contained in AT&T's prospectus describing the soon-to-be divested regional holding companies, analyses prepared by investment firms,

and historical data supplied by South Central Bell, Dr. Westfield arrived at estimates of BellSouth's projected dividends during 1984, the equilibrium price of its stock, and the anticipated growth in the stock price and the Company's dividends. Using this information, he calculated the cost of equity to be approximately 13.3% (midpoint). Dr. Westfield tested the reasonableness of this recommendation by calculating the cost of equity of five, independent telephone companies listed on the New York Stock Exchange. The average, expected rate of return for the five companies is 13.3%, the mid-point of Dr. Westfield's recommended range for BellSouth (Tr. Dec. 8, p. 253). He also calculated the cost of capital for BellSouth using the Capital Asset Pricing Model and once again concluded that the cost of equity was in the range of 12.5 to 14% (Id. p. 256).

Two additional factors lend support to Dr. Westfield's conclusion. BellSouth stock is presently selling at a market-to-book ratio of one which is an indication that the utility is earning a fair rate of return. See Nosh, "Recent Trends in Cost of Capital," 72 Public Utilities Fortnightly, 19, 21-26 (Sept. 26, 1963). BellSouth's two operating utilities, South Central Bell and Southern Bell, earned approximately 13.6% on their combined book equity in 1982 and the first half of 1983 (Id. p. 252). In other words, BellSouth's present rate of return on equity, 13.6%, is a fair guide to its market cost of equity since the stock is presently selling at a market to book ratio of one and it is not anticipated that the Company will need to raise additional equity during the next year.

A second factor to be considered is that, based on testimony in August, 1982, this Commission determined that the cost of equity for South Central Bell was 15.5% in the Company's last rate case. As Dr. Westfield testified (Id. p. 267, 334-336) the dramatic rise in the stock market since the summer of 1982 leaves little doubt that equity is cheaper now than it was at that time when the prime interest rate was two and one-half to five points higher than the present rate.

The Company's witnesses testified that the cost of equity to BellSouth was no lower than that of an average industrial company, a

Dr. Westfield's approach looked specifically at BellSouth and used the Company's actual, past earnings to project dividend growth during the coming year. His methodology was used by one Bell witness (Tr. Dec. 5, p. 82-83), though not to determine the cost of capital for BellSouth, and endorsed by another as one of the generally accepted methods of determining growth (Tr. Dec. 6, p. 263). Furthermore, Dr. Westfield's estimate of BellSouth's dividend yield in 1984 is consistent with the predictions of other analysts (Tr. Dec. 9, p. 297) and his recommended return on equity is approximately the same as the forecasted returns of other telephone companies whose stocks are publicly traded (Tr. Dec. 9, p. 253). For these reasons we find that the appropriate cost of equity to use in this case is 13.25%, the mid-point of Dr. Westfield's range.

VI. DESTIMULATION

In determining the amount of revenue to be generated by the proposed tariffs the Company attempted to quantify the impact of demand stimulation and destimulation resulting from the proposed rate changes. Although the impact as determined from the Company's econometric studies was $11,602,000 only two and one half pages of prefiled testimony were entered into the record.

Dr. Westfield testifying on behalf of the Staff provided the most detailed analysis of the econometric demand models used by the Company in determining the impact and after citing numerous flaws concluded that little if any use could be made of the models used by the Company in this proceeding. He did however, agree that properly developed and utilized the econometric demand studies, and econometric cost studies should be considered in the regulatory process. On the basis of Dr. Westfield's testimony, we find that the studies as used by the Company in this proceeding are inadequate and therefore should not be considered in determining the rates needed to produce the required revenues. In order that we may consider this type of information in future cases, we request the Company to explore further methods for developing economic demand studies in light of the criticisms raised in this hearing.

III. RATE DESIGN

The Company, through the testimony and exhibits of witness John Ebert, sponsored revised tariffs designed to produce an annual revenue increase of $279,555,000 for the forecasted test period ending December 31, 1984. The following schedule summarizes the proposed rate changes of the Company:

South Central Bell Telephone Company

	Annual Value
Basic local flat rate exchange and related services: Including residence and business basic local service, exchange trunks, grouping service, etc.	$ 264,044,000
Long distance service	- 17,014,000
Zone charges	2,349,000
Coin telephone service	6,678,000
Service charges	8,008,000
Directory assistance repricing	10,388,000
Miscellaneous services: Including operator assistance, verification, directory listings, touch tone service, DID service, etc.	7,302,000
Independent company settlements	- 2,200,000
Total annual revenue increase	$ 279,555,000

The Company's proposed tariffs for basic local flat rate exchange service include a reduction in the number of groups used to determine the level of local service rates in each exchange from the existing 12 groups to 5 groups. In addition, customers from exchanges which do not presently have the capability to furnish measured service would receive a 10% lower rate until measured service was provided. Increases range from $14.80 to $16.00 per month for residential flat rate lines, while business flat rate line increases range from $29.35 to $33.55 per month.

The Company proposed to reduce the factors used to determine the PBX Trunk rate and the grouping charge for multi-line systems from 1.75 to 1.55 times the business 1-party flat rate charge. The minimum for measured rate lines would also go down from .70 to .60 times the flat rate line charges.

The proposed tariffs contain rates for long distance service which produce an overall reduction of 30% in long distance Direct Distance Dialed revenues, these reductions would reduce intra-LATA toll revenues by $17,014,000.

The Company's proposal includes an increase in zone charges of approximately 25%. This would increase the zone charge for a 1-party line from $1.35 to $1.70 per month, per zone. This proposed increase will produce $2,349,000 in additional annual revenues.

The local coin telephone rate is proposed to increase from 10c to 25c per call. The Company's revenue projection estimates that the proposed increase in the local coin rate will produce approximately $6,678,000 in additional annual revenues.

Directory Assistance Charges

The Company requested a Directory Assistance Repricing Plan which would establish a charge of 30c per call for all calls to directory assistance above an allowance of five (5) calls per month. The Commission is of the opinion that the Directory Assistance Repricing Plan should be denied. We realize that the general customer body is paying for directory assistance through local service rates; however, we believe that the customer body at this time is satisfied with the current pricing method.

Coin Telephone Rates

South Central Bell has proposed raising the cost of a coin telephone call from 10c to 25c, and presented a study by Shockley Research, Inc. purporting to show attitudes of Tennessee residential customers toward the proposal. The survey revealed that residential customers would rather have the coin rate raised than their residential rates increased. Low-income intervenor witness Dr. Michael Miller testified that the Shockley survey was biased because it induced a specific response; because the question was not neutrally worded.

Because local coin telephone service may be the only telephone service some citizens have available to them and many others use this service as an emergency network, we find that the public's interest is best served by denying the proposed increase in the local coin rate.

Direct Inward Dialing Service

In its March 23, 1983 order in Docket No. U-82-7173, the Commission directed the Company to file tariffs in its next general rate filing to restructure and reprice its DID rates consistent with the AT&T recommendation on DID service. The next general rate filing after that order was this proceeding, and the Company's proposed DID tariffs comply with that order.

Direct Inward Dialing service allows calls to a PBX to be switched directly to a number terminating behind the PBX. The DID service requires central office DID number assignments and specially equipped incoming PBX lines. Under the Company's prior DID offering, the charges for reserving number blocks and for equipping trunks were bundled together. However, under the proposed tariff, the charges for number blocks will be separate from the charges for specially equipping the incoming trunks.

The proposal to unbundle DID service is particularly appropriate, because customer needs for trunks vary widely. Many customers require a specially equipped trunk for every ten DID numbers while other customers, with much shorter holding times, can accommodate 100 DID numbers on two specially equipped trunks. Therefore, the proposed tariff will allow the customer to obtain service tailored to his specific needs but to avoid bundled charges for services that he does not need.

The only party who opposed the DID proposal was the RCC intervenor, TARU. That opposition was based on a desire to continue the present arrangement pursuant to which RCCs purchased DID numbers under contract rates lower than the proposed tariff. The RCCs contend that they are entitled to more favorable rates because (1) they purchase DID numbers in much greater quantity than other subscribers and (2) they use DID numbers, in connection with paging services, for only one-way communications, while other subscribers use the DID numbers for two-way communications.

South Central Bell has indicated that it intends to continue providing DID numbers to RCCs under contract until the Commission decides whether access service tariffs should be applied to RCCs. As a result of a pre-hearing motion by TARU, a separate docket will be established to consider the application of access service tariffs to RCCs. It appears that the issue of DID service to RCCs is related to the access service tariff issue because at least one charge under the DID tariff, the "trunk termination charge," would be also contained in the access services tariff proposed for RCCs.

In view of (1) South Central Bell's expressed intention to continue the contracts with RCCs, and (2) the relationship between the DID service provided to RCCs and the access services tariff proposed for RCCs, the Commission approves the DID tariff as filed, with the exception that the provision of DID numbers to RCCs will continue under present contracts and the level of rates in these contracts will be considered by the Commission in the docket established relative to the application of access service tariffs to RCCs.[5/]

Complex Inside Wiring Service

The Company has proposed a change in its method of charging for complex inside wiring. The flat recurring charges would be eliminated and replaced with a time-and-materials charging (TMC) plan for maintenance functions. The cost of maintenance is currently included in the recurring wiring rate, but the availability of alternative suppliers makes the identification of South Central Bell provided wire difficult. The provision of maintenance under the proposed TMC plan eliminates the mismatches of provision of maintenance and billing for maintenance. The new environment also eliminates South Central Bell's source of information on discrete customer wiring activity, thereby making the continuation of the recurring charges difficult.

The staff proposes the continuation of recurring charges for customers with South Central Bell complex inside wiring for embedded systems as a means of recovering the remaining net investment. The staff also recommends TMC for the maintenance function and the development of a sales plan which would establish purchase prices for complex inside wire based on a relationship to the monthly rate of each customer.

As an alternative that addresses the staff's interests, yet recognizes the administrative problems attendant to their proposal, the Company proposes a "frozen" recurring billing to customers of record on December 31, 1983. The billing to these customers would continue at the December 31, 1983 level and provide a revenue stream toward the embedded investment. Maintenance would be provided under the

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5/ Docket No. U-6703 is a tariff filing by South Central Bell to no longer provide series 5000 wide band channels for new installations after December 31, 1983. That docket has remained open and is superseded by this Order and should be closed by the terms of this Order. Electric service will be maintained at reasonable levels for December 31, 1984.

TMC plan.

The Commission is of the opinion that the monthly recurring charges for complex inside wiring should be continued to aid in the recovery of the cost of this wiring. We also believe that the Company should offer this wiring for sale to its customers at prices based on the recurring monthly billing to each customer. Therefore we direct the Company to file a plan within sixty (60) days of this order, that establishes sale prices for complex wiring, based on the recurring charges customers pay.

Local Measured Service

South Central Bell currently offers three optional local measured service plans to its residence customers. The Commission has previously approved these plans in order to permit customers to choose one of these lower priced options, if their telephone usage is such, that it permits them to save money. The Low Income Intervenors have proposed to halt the offering of all local measured service until studies are conducted showing the costs, impact on universal service and alternative rate designs.

The Commission believes that the continued offering of local measured service is in the public interest. All subscribers, including Low Income Subscribers can elect to receive service under one of these optional plans, which can save a customer up to 60% of the monthly residential flat rate. If experience or future study indicates that equity and fairness to subscribers require changes in the local measured service plans, the Commission will move swiftly to implement those changes.

Telpak Service

On December 6, 1983, as a preliminary matter, the Commission approved the motion of Intervenor, State of Tennessee, to remove from South Central Bell's proposed tariff the elimination of the Telpak offering, subject to the following conditions:

1. Effective January 1, 1984, the Inter-LATA parts of the Telpak offering will be provided by AT&T Communications of the South Central States, Inc. and the Intra-LATA part of the Telpak offering will be provided by South Central Bell.

2. Effective January 1, 1984, the applicable rate for both the Inter-LATA and the Intra-LATA parts of the Telpak offering will be increased by 20% over the existing rates.

3. Both the Inter-LATA and the Intra-LATA parts of the Telpak offering will terminate on December 31, 1984.

4. The maximum capacity for each Inter-LATA and Intra-LATA Telpak billing option group, respectively, will be the present combined capacity for existing Telpak billing option groups currently obtaining an Inter-LATA and Intra-LATA mix, and is limited to parallel service between the points currently receiving Telpak service.

Therefore, the tariffs filed should reflect the continuation of the Telpak offering subject to the above stated qualifications.

The Commission further adopts the following, staff recommended, modifications to the tariffs as filed by the Company on July 8, 1983:

A. Basic Local Service Rates:

1. Five group local service rate schedules with no premium for exchanges which have measured service available.

2. PBX and ESSX trunk rate established at 1.75 times the business flat rate charge.

3. Apply a grouping charge of 75¢ uniformly to all classes of customers.

4. Make no changes in the existing rate structure of measured rate service.

B. Service Charges:

1. Eliminate the access line costs from the Central Office Line Connection Rate.

C. Other Services:

1. Reduce the group emergency alerting and dispatch service rate increase to 25%.

2. No change in the existing rates for message toll, WATS, and zone charges.

In summary, the Commission is of the opinion that the tariffs filed by the Company on July 8, 1983 should be denied. The Company has been directed to file revised tariffs which produce the additional annual revenue requirement of $39,301,000[6/] in accord with the findings previously set forth in this order.

6/ See Appendix B for a calculation of the rate award.

IT IS THEREFORE ORDERED:

1. That the tariffs filed by South Central Bell on July 8, 1983, designed to produce $279,555,000 in additional annual revenues be, and the same are hereby, denied.

2. That the tariffs filed by the Company in response to our findings, designed to produce additional annual revenues not to exceed $39,301,000, are hereby made permanent and our Order of January 6, 1984, approving those tariffs is incorporated herein.

3. That the November 25, 1983 Order of Administrative Judge Mack Cherry on the applicability of the Company's intrastate access charges to Radio Common Carriers is incorporated herein by reference. A docket captioned "Proposed Application of Intrastate Access Charges and Direct Inward Dialing Tariffs by South Central Bell to Radio Common Carriers" shall be established as Docket U-84-7279, to deal with these access charges and the DID charges discussed on page 35 of this Order.

4. That our Order of December 22, 1983, relating to the application of the Company's Intrastate Access Charges to authorized inter-LATA toll carriers is incorporated by reference. A docket captioned "Intrastate Access Charge Tariff Filing of South Central Bell Telephone Company" shall be established as Docket U-84-7280.

5. That our Order of December 30, 1983, relating to Wide Area Toll Service (WATS) shall be incorporated by reference.

6. That South Central Bell is ordered to file the "Cost Studies" discussed on page 22 of this Order at least one month before its next general rate filing.

7. That South Central Bell is ordered to file the budget tracking reports discussed on page 23 of this Order with the Commission's Accounting Division on a monthly basis.

8. That South Central Bell is ordered to file a sales plan within sixty (60) days of the date of this Order setting forth sales prices for complex intrasystem wiring as discussed on page 36 of this Order.

9. That the Company in its next rate filing shall incorporate the Commission's Standard Adjustments as an alternative to the Company's unadjusted figures.

10. That the Company's next rate filing shall include a quantification of employee concessions for intra-LATA toll calls.

11. That all motions not previously ruled upon are hereby denied.

12. That any party aggrieved with the Commission's decision in this matter has the right of judicial review by filing a Petition for Review in the Chancery Court of Davidson County within sixty (60) days from and after the date of this order.

CHAIRMAN

COMMISSIONER

COMMISSIONER

ATTEST

EXECUTIVE DIRECTOR

Previously it was explained that as a result of the unusual circumstances in this case we have utilized the forecast of revenues, expenses, and investment for the calendar year 1984. We have adopted the forecast reluctantly and as a result will require the company to file monthly tracking reports showing the actual combined and intrastate revenues, expenses, investment etc. in comparison with the budgeted amount in the same format as identified in the September view of the budget. The company shall also provide a detailed comparison of the actual construction program with the September budget view and shall provide detailed explanations of significant deviations.

In light of these findings, the following table of revenues and expenses incorporates the adjustments heretofore discussed. We find this revised income statement appropriate for use in this proceeding.

SOUTH CENTRAL BELL TELEPHONE COMPANY
Tennessee Intrastate
Revised Income Statement
1984
(000)

Line No.		Staff Exh. Schedule 4	Adjustment	Revised Staff
	Revenues:			
1	Local Service	$ 453,674	$ 0	$ 453,674
2	Toll Service	204,202	-1,596	202,606
3	Miscellaneous	71,882	0	71,882
4	Interest During Construction	3,583	0	3,583
	Less:		0	
5	Uncollectibles	-2,684	84	-2,600
6	Total Revenues	$ 730,657	$ -1,512	$ 729,145
	Expenses:			
7	Interest on Customer Deposits	$ 650	$ 0	$ 650
8	Maintenance	159,210	0	159,210
9	Depreciation	114,414	0	114,414
10	Traffic	37,893	0	37,893
11	Commercial and Marketing	69,700	0	69,700
12	Accounting	14,166	0	14,166
13	General	29,385	0	29,385
14	Operating Rents	17,072	0	17,072
15	Relief and Pensions	48,048	0	48,048
16	General Service and Licenses	7,720	-1,447	6,273
17	Miscellaneous Income Charges	487	0	487
18	Federal Income Tax	47,322	-28	47,294
19	F.O.A.B. and U.C.Tax	15,431	0	15,431
20	State and Local Tax	54,382	-3	54,379
21	CPE Cost Allocated To Interstate	-11,445	0	-11,445
22	Total Expense	$ 504,435	$ -1,478	$ 502,957
23	Net Operating Income	$ 126,219	$ -34	$ 126,185

APPENDIX A

On December 16, 1983, AT&T Communications, South Central Bell, General Telephone of the Southeast, United Inter-Mountain, and the Staff stipulated to an interim procedure providing the use of access charges designed to provide South Central Bell and the other local telephone companies with the level of toll support that would have been realized had the current division of revenue approach been continued in 1984. In an Order issued December 22, 1983, in this proceeding, the Commission approved the interim procedure which reduced the revenue requirements of South Central Bell.

In arriving at the interim settlement, however, the Staff used different figures to calculate ATTCOM's cost of service than were used in developing the Staff's exhibits previously filed in this rate case. In developing the cost of service for AT&T Communications as originally filed in this case, as shown on schedule 10 of the Staffs exhibit, it was assumed that ATTCOM would be liable for the gross receipts tax only on the revenue it will retain after paying access charges to SCB. During the development of the interim access charge arrangement, the Tennessee Department of Revenue determined that AT&T Communications will be liable for gross receipts tax computed on the basis of the total inter-LATA revenues it collects. As a result, AT&T Communications cost of service must be increased. This increase and other changes to recognize interest during construction, capitalized relief and pension cost, and disallowed depreciation resulted in AT&T Communications cost of services being increased from $19,333,000 to $20,929,000. As a result, South Central Bell's toll revenue under current rates as shown on Staff Exhibit 28 schedule 4 was reduced from $204,202,000 to $202,606,000. The revenues and uncollectibles as presented on schedule 4 and as adjusted are presented below:

	Staff Exhibit Schedule 4 (000)	Adjustment (000)	Restated (000)
Revenues:			
Local	$453,674		$453,674

Toll Service	204,202	1,596	202,606[A/]
Miscellaneous	71,382		71,382
Interest During Construction	3,560		3,560
Less:			
Uncollectible	2,684	84	2,600[B/]
	$730,654	$ 1,512	$729,142

A/ Toll Revenue Exhibit 28 Schedule 8 $223,400 + 135 - $20,929 = $202,606

B/ ($453,674 - $202,606 - Access charge revenue $61,558 + 71,882) x .0039 = $2,600.

SOUTH CENTRAL BELL TELEPHONE COMPANY

TENNESSEE INTRASTATE

CALCULATION OF GROSS REVENUE REQUIREMENTS

"000"

Line No.		
1.	Net Operating Income Under Present Rates as Adjusted - Page 23	$126,185
	Net Operating Income Effect for Change in Debt Cost:	
2.	State Excise Tax -	37 A/
3.	Federal Income Tax -	281 B/
4.	Net Operating Income Available for Return (L1+L2+L3)	$126,503
5.	Net Operating Income Required Rate Base Page 11 $1,296,215 X .113 =	$146,472
6.	Additional Net Operating Income Prepaid (L5-L4)	$ 19,969
7.	Additional Gross Revenue Required (L6 x .5081C/)	$ 39,301

A/ Increased Interest using 8.9% debt cost x Excise Tax Ex. 28 Sch. 32, $648 x 5.53% = $37 decrease.

B/ Increased Interest plus excise change x .46 ($648 + (37) = 611 x .46 = $281 decrease.

C/ Ex. 28 Sch. 31

BEFORE THE TENNESSEE PUBLIC SERVICE COMMISSION

NASHVILLE, TENNESSEE

IN RE: PETITION OF SOUTH CENTRAL BELL TELEPHONE COMPANY TO CHANGE AND INCREASE CERTAIN RATES AND CHARGES FOR INTRASTATE TELEPHONE SERVICE

DOCKET NO. U-83-7248

D I S S E N T

I dissent from the majority decision finding an overall return of 11.3% for South Central Bell in this proceeding. The majority has placed sole reliance on the testimony of the Commission staff witness, Dr. Fred Westfield, and has not given any weight to other evidence submitted by four expert witnesses who also testified on this important issue. In view of the wide variation between the staff witness and the other experts (11.3% vs. 13.25%), I think the conclusion reached is erroneous in light of the entire record.

The determination of the overall cost of capital is, on its face, apparently a simple process. The starting point is the capital structure, and in this record, it is uncontroverted that South Central Bell's capital structure is made up of 45% debt and 55% equity. To obtain the weighted cost of the Company's capital, one must determine the cost of debt and multiply it by 45% and follow the same process using a 55% multiple for the cost of equity. The products are then added together to determine the overall, weighted cost of capital.

My principal concerns arise from clearly erroneous debt and equity costs relied upon by Dr. Westfield. In computing the cost of debt, Dr. Westfield acknowledged he substantially understated the cost of short term debt. Both Chairman Bissell and I commented on that error in the Commission Conference, but the 11.3% overall cost of capital adopted by the Commission does not correct Dr. Westfield's error. The record only supports a conclusion that the cost of short term debt in 1984 will be over 9.0%, not the 8.2% used by Dr. Westfield. Therefore, if Dr. Westfield had made no other errors, the overall cost of debt should be increased by 0.2% to 9% and the overall cost of capital by 0.1%. However, Dr. Westfield also erred in his calculation of the cost of equity.

Dr. Westfield utilized the "Discounted Cash Flow" (DCF) method which, although originally proposed by its author for another purpose, is recognized as a means of determining investor expectations and inferentially the cost of equity capital to the utility. The problem, I find, however, is that in the application of the DCF formula there are judgement decisions on the part of the expert, but unless that judgement is sound and reasonable, it is as with any good computer badly programmed, "garbage in, garbage out." The resulting cost of capital approved by the majority is lower than that approved for this Company by the Commission in 1981 and, according to the statement of the Chairman during the Commission Conference, is the lowest return approved by any of the state commissions for Bell in the country.

The obvious errors in judgement by the staff witness are as follows:

a) Dividend Yield -- To compute the prospective dividend yield in the DCF formula, it is necessary to determine both the prospective annual dividend and the appropriate market price of the stock. Generally, that market price is developed from either the current market price or from some averaged, historical market prices. The record in this case shows that on the two days before Dr. Westfield testified, the closing price for BellSouth stock had been $86.00. The record also shows that the high and low prices at which the stock had ever been traded were $90.50 and $84.75, with the average price being $87.63. Significantly, the market price for BellSouth stock had never been outside the foregoing range.

In his DCF formula computation, Dr. Westfield used a market price range for BellSouth stock of $90.00 to $100.00 with a midpoint of $95.00. The impact of his relying on that erroneous and unrealistic range of market prices is to understate the cost of equity capital by 0.8%. A similar error is also present in his growth range.

b) Growth -- To determine the growth component in the DCF formula, it is possible to rely on different sorts of growth projections related to a particular stock. Two common projections used in calculating a DCF growth rate are projected growth in dividends and in earnings. In fact, Dr. Westfield relied upon dividend growth projections found in Value Line analyses in Exhibit 2 to his testimony.

At the time Dr. Westfield testified a similar, BellSouth-specific Value Line analysis was available. It projected a dividend growth rate for BellSouth of 6.5% and an earnings growth rate of 8.0%. A range of growth estimates between 6.0% and 8.0% was supported by other investment service projections introduced

into the record. However, Dr. Westfield refused to accept such growth rates for BellSouth, despite his reliance on the same estimates elsewhere in his testimony. Instead, he offered his own earnings growth factors of 4.2% to 4.9%, which appear unsupported and arbitrary. The impact of his growth rate error alone was to understate the cost of equity capital by at least 1.1%. The combined impact on the overall cost of capital of Dr. Westfield's DCF input errors is to understate that cost by 1.0%.

The foregoing departures from fact by Dr. Westfield in his application of the DCF formula are obvious and egregious errors which substantially detract from the merit of his testimony. Furthermore, the proof in this record supports the conclusion that there has been no material change in the overall cost of capital since this Commission's decision of September, 1982 in Docket No. U-82-7161 wherein the Commission authorized South Central Bell to earn a 12.5% overall rate of return. The cost of debt and the cost of equity capital, as determined through the DCF formula, were essentially the same in September, 1982 and in December, 1983. Therefore, the significant change in the authorized rate of return ordered in the majority opinion cannot be predicated upon the preponderance of, or even substantial, credible evidence in this record. Additional confirmation of Dr. Westfield's errors is found in the proof regarding the current yield of 12.78% on South Central Bell's bonds. It is generally accepted that a company's long-term debt cost is 2% to 3% lower than the same company's equity cost. Such should be the case here, but isn't.

Moreover, the record contains the testimony of Messrs. Matheson, Todd, Prior and Brigham, all experts in the field, who agree that the proper return on equity would be in the range of 16% - 18%. The lower end of this range, 16%, is significantly higher than the top of Dr. Westfield's range of 14%. To accept Dr. Westfield's mid-range finding without giving any weight to substantial testimony based on experienced judgments, in addition to his misuse of the DCF formula, is not consistent with our statutory duty. In fact, the result is so one-sided as to appear to indicate an objective of reducing the Company's previously authorized return of 12.5% overall, 15.25% on equity, to the lowest possible level. Such action is unrealistic if at the same time one expects the Company to fairly compensate its equity holders under the standards of the Hope and Bluefield decisions and to meet the service demands of its customers and the standards legally required by this Commission.

JANE L. STOCKARD
Commissioner

C

Supreme Court of Tennessee.
POWELL TELEPHONE COMPANY, Appellant,
v.
TENNESSEE PUBLIC SERVICE COMMISSION and Frank D. Cochran, Keith Bissell and Jane Eskind, Commissioners, Appellees.
Nov. 14, 1983.

Telephone company appealed from judgment of the Equity Court, Davidson County, Robert S. Brandt, Chancellor, upholding accounting method used by the Public Service Commission in determining appropriate rate increase to be awarded. From affirmance by the Court of Appeals, telephone company applied for discretionary review. Upon grant of application, the Supreme Court, Fones, C.J., held that the Public Service Commission was not required to use year-end rate base rather than average year rate base in determining appropriate rate increase to be awarded to telephone company.

Affirmed.

West Headnotes

Telecommunications 372 ⇐945(1)

372 Telecommunications
372III Telephones
372III(G) Rates and Charges
372k937 Determination of Rates
372k945 Valuation
372k945(1) k. In General. Most Cited Cases
(Formerly 372k318.1, 372k318)
Public Service Commission was not required to use year-end rate base rather than average year rate base in determining appropriate increase to be awarded to telephone company.

*44 Rebecca Thomas, Howser, Thomas, Summers, Binkley & Archer, Nashville, Hermann Ivester, H. Edward Skinner, Little Rock, Ark., for appellant.
Henry Walker, Attorney for the Tennessee Public Service Commission, Nashville, for appellees.

OPINION

FONES, Chief Justice.
We granted the Powell Telephone Company's [Company] application for discretionary review that presented a single issue which, in essence, was whether the evidence required the Public Service Commission [Commission] to use a year end rate base rather than the average year rate base in determining the appropriate increase to be awarded.

The Commission held extensive hearings and heard highly disputed testimony and evidence concerning which method to use in determining a proper rate base upon which ***45** the Company should be allowed to earn a fair rate of return. The Company sought an annual increase in revenues of $760,422. The Commission used the average year rate base method, which the Commission staff had advocated, which resulted in approval of an increase designed to yield $484,444 in additional annual revenues. The chancellor found that he must give deference to the Commission's expertise and technical competence in the rate making process and found substantial evidence "for the Public Service Commission's decision on rate of return on equity" and affirmed the Commission's order. The Court of Appeals affirmed the chancellor's decree. We also affirm.

The issue of whether and under what circumstances a regulatory commission should use an average rate base or a year end rate base has been frequently litigated in our sister states but the issue has not been addressed in any reported decision of Tennessee courts. *See, Legislative Util. Consumers' Council v. Granite State Elec. Co.,* 119 N.H. 359, 402 A.2d 644 (1979); *Citizens of Florida v. Hawkins,* 356 So.2d 254 (Fla.1978); *Providence Gas Co. v. Burman,* 376 A.2d 687

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(R.I.1977); *Pub. Serv. Com'n. of Maryland v. Baltimore Gas & Elec. Co.,* 273 Md. 357, 329 A.2d 691 (1974).

The weight of authority appears to favor use of an average rate base on the premise that in normal economic times average rate base is more realistic and projects more accurately the cost of plant that produces the revenue under investigation. However, there is well recognized authority that in an abnormal and less stable economic climate, year end rate base may be more appropriate and should be used to balance out the financial problems caused by an abnormal and uncertain economy.

The Tennessee Public Service Commission has utilized both accounting methods in determining rate base. According to the Commission one of the key factors in choosing one method over another is a company's rate of return. The ratio of the company's net income to its rate base provides its rate of return. The Commission contends that when a company's return on investment is relatively stable the average rate base method is used. Conversely, when a company is experiencing extraordinary growth which outstrips growth in revenues, then an end of year rate base method is used.

In this case both the Commission staff and the Company used as the test period the calendar year 1979. The use of the average investment over the test year assumes that, even though the actual figures for expenses and revenues will rise in the future, the relationship between investment and income will not change significantly.

The Company concedes that the average rate base method may be appropriate during times of stable prices, wages and investment but asserts that it is " clearly inadequate when the utility faces the ravages of inflation."

Suffice it to say there was an abundance of evidence and argument presented to the Commission by the Company in support of its position that the year end rate base should be used in this case and the Commission staff presented an abundance of evidence and argument in support of the use of the average rate base.

The Commission decided that the average rate base developed by the staff presented a proper and accurate indication of the results of operations to be expected in the immediate future of the Company, and set rates accordingly.

Appellant relies heavily upon language from an unpublished opinion and order denying certiorari in *South Central Bell Telephone Co. v. Tenn. Pub. Serv. Comm'n,* 579 S.W.2d 429 (Tenn.App.1979), cert. den. The statement relied upon is:
We do not construe the opinion of the Court of Appeals as mandating the use of a forecast year test period, but merely as requiring that the Commission take into consideration not only all known changes but also all that are fairly and reasonably anticipated, with due consideration to past expenditures and those required to permit the Company to render efficient service.

***46** The Company asserts that the above statement mandated the use of the year end rate base method because the difference between the Company's 12-31-79 rate base and its average 1979 rate base is a known and measurable change in investment.

The Company makes no reference to the paragraph in that order immediately following the above-quoted statement, which paragraph reads as follows:
Moreover, it rests within the sound discretion to use an historical test period, a forecast period, a combination of these where necessary or any other accepted method of rate making necessary to give a fair rate of return-the ultimate goal being to assure efficient service to the consumer and a fair return on its investment to the company.

We find it unnecessary to analyze what this Court said in denying certiorari in *South Central Bell Telephone Co. v. Tenn. Pub. Serv. Comm'n., supra,* in the context of the Court of Appeals' opinion in that case. The controlling exposition of the law applicable to the instant case was set forth in the later case of *CF Industries v. Tenn. Pub. Serv. Comm.,* 599 S.W.2d 536 (Tenn.1980). Therein,

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(Cite as: 660 S.W.2d 44)

the Court clearly negated the idea that the Commission is bound to follow any particular rate making methodology.
There is no statutory nor decisional law that specifies any particular approach that must be followed by the Commission. Fundamentally, the establishment of just and reasonable rates is a value judgment to be made by the Commission in the exercise of its sound regulatory judgment and discretion. *Id.* at 542.

The Court also held that the scope of review was governed by T.C.A. § 4-5-117, now T.C.A. § 4-5-322, which restricts reversal or modification to those cases where the reviewing court finds that the Commission's decision is
(4) Arbitrary or capricious or characterized by abuse of discretion or clearly unwarranted exercise of discretion; or
(5) Unsupported by evidence which is both substantial and material in the light of the entire record. In determining the substantiality of evidence, the court shall take into account whatever in the record fairly detracts from its weight, but the court shall not substitute its judgment for that of the agency as to the weight of the evidence on questions of fact.

We find that the Commission's use of the average year rate base was supported by ample material and substantial evidence and involved no abuse of discretion.

The judgment and opinion of the Court of Appeals is affirmed. Costs are adjudged against Powell Telephone Company.

BROCK, HARBISON and DROWOTA, JJ., and HUMPHREYS, Special Justice, concur.
Tenn.,1983.
Powell Telephone Co. v. Tennessee Public Service Com'n
660 S.W.2d 44

END OF DOCUMENT

599 S.W.2d 536
(Cite as: 599 S.W.2d 536)

C

Supreme Court of Tennessee.
CF INDUSTRIES, Appellee,
v.
TENNESSEE PUBLIC SERVICE COMMISSION et al., Appellants.
May 19, 1980.

Public Service Commission appealed from order of the Court of Appeals reversing the Chancery Court's affirmance of a natural gas rate increase approved by the Commission. The Supreme Court, Henry, J., held that: (1) Commission's action in eliminating the special rate given to the largest industrial user of natural gas and raising rates for other industrial users was supported by material and substantial evidence; (2) Commission's findings of fact were adequate for judicial review; (3) Commission did not exceed its regulatory judgment and discretion in changing rate design without use of a cost of service study; and (4) there was a lack of pleading and procedural predicate for consideration of the issue that exempting residential customers from the rate increases was discriminatory, and there was no evidence that there was no material basis for the differing rates, and thus, Commission did not establish unjustly discriminatory or preferential rates.

Reversed.

West Headnotes

[1] Administrative Law and Procedure 15A 683

15A Administrative Law and Procedure
15AV Judicial Review of Administrative Decisions
15AV(A) In General
15Ak681 Further Review
15Ak683 k. Scope. Most Cited Cases
Supreme Court cannot, as a general rule, afford any broader or more comprehensive review to cases arising under Uniform Administrative Procedures Act than is afforded to them by trial court in the first instance. T.C.A. §§ 4-5-117, 4-5-117(g, h).

[2] Administrative Law and Procedure 15A 683

15A Administrative Law and Procedure
15AV Judicial Review of Administrative Decisions
15AV(A) In General
15Ak681 Further Review
15Ak683 k. Scope. Most Cited Cases
Concurrent finding between agency and trial court on any issue of fact is conclusive upon Supreme Court.

[3] Public Utilities 317A 195

317A Public Utilities
317AIII Public Service Commissions or Boards
317AIII(C) Judicial Review or Intervention
317Ak188 Appeal from Orders of Commission
317Ak195 k. Presumptions in Favor of Order or Findings of Commission. Most Cited Cases
(Formerly 317Ak33)
There is presumption that rates established by Public Service Commission are correct and any party who attacks Commission's findings has burden of proving that they are illegal or unjust and unreasonable. T.C.A. § 65-520.

[4] Gas 190 14.3(3)

190 Gas
190k14 Charges
190k14.3 Administrative Regulation
190k14.3(3) k. Proceedings in General. Most Cited Cases
Action of Public Service Commission in eliminating special rate given by utility to largest industrial user of natural gas and raising rates for other industrial

users was supported by material and substantial evidence. T.C.A. §§ 4-5-117(h)(5), 65-520.

[5] Administrative Law and Procedure 15A 489.1

15A Administrative Law and Procedure
15AIV Powers and Proceedings of Administrative Agencies, Officers and Agents
15AIV(D) Hearings and Adjudications
15Ak489 Decision
15Ak489.1 k. In General. Most Cited Cases
(Formerly 15Ak489)
Requirement under Uniform Administrative Procedures Act that "A final decision shall include findings of fact, conclusions of law, and reasons for the ultimate decision," is a statutory imperative; it is not a mere technicality but is an absolute necessity without which judicial review would be impossible. T.C.A. § 4-5-113.

[6] Administrative Law and Procedure 15A 486

15A Administrative Law and Procedure
15AIV Powers and Proceedings of Administrative Agencies, Officers and Agents
15AIV(D) Hearings and Adjudications
15Ak484 Findings
15Ak486 k. Sufficiency. Most Cited Cases
Where there is no disputed issue of fact and sole question before agency is proper conclusion to be drawn from undisputed facts and application of the correct legal rules, record need not be burdened with detailed findings of fact; in such a case facts need only be recited.

[7] Administrative Law and Procedure 15A 486

15A Administrative Law and Procedure
15AIV Powers and Proceedings of Administrative Agencies, Officers and Agents
15AIV(D) Hearings and Adjudications
15Ak484 Findings
15Ak486 k. Sufficiency. Most Cited Cases
In cases wherein issues of fact before agency are sharply contested and proof is conflicting, a detailed finding of fact dovetailed to the record is a practical and legal imperative.

[8] Gas 190 14.4(1)

190 Gas
190k14 Charges
190k14.4 Reasonableness of Charges
190k14.4(1) k. In General. Most Cited Cases
Cost of service is not an exclusive method of determining rate design.

[9] Gas 190 14.3(4)

190 Gas
190k14 Charges
190k14.3 Administrative Regulation
190k14.3(4) k. Findings and Orders. Most Cited Cases
In proceeding resulting in elimination of special rate for natural gas provided to largest industrial customer of gas utility, Public Service Commission's findings of fact were adequate to allow judicial review. T.C.A. § 4-5-113.

[10] Public Utilities 317A 120

317A Public Utilities
317AII Regulation
317Ak119 Regulation of Charges
317Ak120 k. Nature and Extent in General. Most Cited Cases
(Formerly 317Ak7.1)
Establishment of just and reasonable public utility rates is a value judgment to be made by Public Service Commission in the exercise of its sound regulatory judgment and discretion. T.C.A. § 65-518.

[11] Public Utilities 317A 165

317A Public Utilities
317AIII Public Service Commissions or Boards
317AIII(B) Proceedings Before Commissions
317Ak165 k. Evidence. Most Cited Cases
(Formerly 317Ak15)

Public Service Commission in rate making and design cases is not solely governed by the proof, although there must be adequate evidentiary predicate; Commission may consider all relevant circumstances shown by the record, all recognized technical and scientific facts pertinent to the issue under consideration and may superimpose upon entire transaction its own expertise, technical competence and specialized knowledge. T.C.A. § 4-5-1097.

[12] Gas 190 ⚿14.1(2)

190 Gas
190k14 Charges
190k14.1 In General
190k14.1(2) k. Uniformity of Charges; Discrimination. Most Cited Cases
Action of Public Service Commission in changing rate design so as to eliminate special rate for natural gas provided to largest industrial customer of gas utility without use of a cost of service study did not exceed its regulatory judgment and discretion. T.C.A. § 65-518.

[13] Gas 190 ⚿14.5(6)

190 Gas
190k14 Charges
190k14.5 Judicial Review and Enforcement of Regulations
190k14.5(6) k. Scope of Review and Trial De Novo. Most Cited Cases

Gas 190 ⚿14.5(9)

190 Gas
190k14 Charges
190k14.5 Judicial Review and Enforcement of Regulations
190k14.5(9) k. Determination and Disposition. Most Cited Cases
In rate-making cases, sole concern of courts, at each stage of appellate review, is to determine whether Public Service Commission's action on the matters raised by the application meets the requirements of the law; rate making is not a judicial function and courts are powerless to remand for determination of a new cause of action.

[14] Gas 190 ⚿14.5(9)

190 Gas
190k14 Charges
190k14.5 Judicial Review and Enforcement of Regulations
190k14.5(9) k. Determination and Disposition. Most Cited Cases
If Public Service Commission's action in rate-making cases is invalid in that rate design approved is discriminatory and without rational basis, only appellate remedy is to strike the increase, in whole or in part, or remand for reconsideration of respective rights of contending parties.

[15] Gas 190 ⚿14.3(3)

190 Gas
190k14 Charges
190k14.3 Administrative Regulation
190k14.3(3) k. Proceedings in General. Most Cited Cases
In proceeding before Public Service Commission involving natural gas rate increase for industrial customers, there was no pleading or procedural predicate for consideration of issue that exempting residential customers from rate increase was discriminatory, and there was no evidence that there was no material basis for the differing rates, and thus, Commission did not establish unjustly discriminatory or preferential rates. T.C.A. § 65-518.

[16] Gas 190 ⚿14.1(2)

190 Gas
190k14 Charges
190k14.1 In General
190k14.1(2) k. Uniformity of Charges; Discrimination. Most Cited Cases
A public utility may impose differing rates among customer classes.

***537** Eugene W. Ward, Gen. Counsel, Mack H. Cherry, Asst. Gen. Counsel, for appellant Public Service Commission.
Eugene N. Collins, City Atty., Gary D. Lander, Sp.

Counsel, Chattanooga, for City of Chattanooga.
Jack M. Irion, Bomar, Shofner, Bomar & Irion, Shelbyville, W. D. Spears, Spears, Moore, Rebman & Williams, W. L. Taylor, Jr., Chattanooga, for Chattanooga Gas Co.
James Clarence Evans, Nashville, Anthony E. Cascino, Jr., Longrove, Ill., for appellee.

OPINION

HENRY, Justice.
This is a utility rate case.

I.

A. Pleadings and Proceedings before the Public Service Commission

On May 31, 1977, Chattanooga Gas Company, a division of Jupiter Industries, filed its application before the Tennessee Public Service Commission seeking to place into effect a revised natural gas tariff and to amend a special contract with CF Industries, Inc. Chattanooga Gas is a natural gas distribution company serving franchises in Chattanooga, Cleveland and environs in Hamilton and Bradley County. CFI is its largest consumer, using approximately 30% of the petitioner's total gas supply.

The proposed rate increase applied to large industrial and commercial customers but did not affect small commercial users nor residential customers. The basic ***538** premise of the application is that a declining gas supply has prohibited the pursuit of practices designed to increase sales volumes to offset heavy increases in operational costs, resulting in an inadequate rate of return. Thus, Chattanooga Gas urges upon the Commission a need to redesign its rates.

It is the theory and philosophy of Chattanooga Gas that there has been a regulatory shift from the traditionally accepted criteria for valuing utility service from "cost of service" to an "intrinsic value" rationale and that this operates to protect residential consumers from absorbing more than their fair share of rates. Chattanooga Gas insists that volume discounts resulting in price advantages to industrial users tend to encourage over-consumption at a time when conservation is a national priority.

CF Industries protested the petition, taking the position that it is the largest customer of Chattanooga Gas, using the gas as a raw product ingredient in the production of fertilizer, and that this unique use justifies a separate rate classification and a continuation of its contract with Chattanooga Gas. [FN1] Its unique use can best be summarized by noting that it is the only customer of Chattanooga Gas which utilizes gas as a raw material; all others use it only as a fuel. CFI can use no other fuel because of the design of its nitrogen complex. It is CFI's further position that its proposed share of the rate increase is disproportionate and discriminatory. CFI insists on the cost of service vis-a-vis the intrinsic value approach.

> FN1. CF Industries relies heavily on the terms of a contract entered into July 6, 1966, between Chattanooga Gas and its predecessor, Farmer's Chemical Association. This contract was assigned to CFI on May 20, 1976.

The Town of Lookout Mountain, Tennessee, intervened in opposition to the increase. The City of Chattanooga intervened for the purpose of preserving its contracts with Chattanooga Gas and protecting the interests of its citizens and rate payers.

To put the entire controversy into focus, we point out that essentially the contending parties are the Chattanooga Gas Company and CF Industries. Under the scheme proposed by Chattanooga Gas the Commission was asked to approve a two-step approach. First, the special rate to CFI would be eliminated and the Gas Company's industrial rate schedule would be made applicable to CFI. Secondly, a general rate increase would be applied to all industrial users, including CFI. The first step would increase CFI's rates by approximately $562,867 annually; the general rate increase would add approximately $157,133. The result would be a

total increase of approximately $720,000, with CFI assuming the same proportionate burden as all other industrial consumers.

B. Findings and Order of the Commission

On November 30, 1977, the Public Service Commission entered its findings and order. The Commission approved the increase in net operating income in the amount of $910,226. It ordered that CFI be charged at its "existing I-1 rate tariff," with the result that approximately $394,866 or 43.4% of the total increase was assessed against CFI with approximately 56.6% being assessed against the remaining 742 industrial consumers. The 25,000 residential users were not affected. The result was that other industrial users were raised and CFI continued to pay at a lower rate. After discussing the testimony relating to the cost of service versus intrinsic value approach, the Commission noted that "CFI is receiving gas at bargain prices under the special contract at a time when natural gas is a scarce commodity."

The Commission treated "cost of service" as "one of many approaches" but held that it was "not bound to a strict cost of service approach in designing rate schedules." The Commission summarized its holding:
Rate-making is an extremely complex process which involves much more than inputting cost figures into a computer and waiting for the results of the machine's mathematical functions. We ***539** must consider all aspects surrounding the determination of just and reasonable rates. In our opinion, a strict cost of service approach is not at this time of decreasing energy supplies the best approach to setting rates. . . . We, therefore, order the company to change the existing rates charged to CF Industries for firm gas to the existing I-1 rate tariff.

The Commission pointed out that "CFI will still be able to purchase gas at a lower effective rate than other industrial customers due to its high load factor. " Further the Commission specificized this finding by noting that "on average the industrial customers other than CF Industries are paying $1.46 per McF under existing rates, while CFI will pay $1.35 per McF under the same rate schedule."

It should be noted that while under the Commission's holding CFI's rate was increased to that being paid by other industrial users at the time the petition was filed, it was not subjected to the general rate increase with the result that it continues to pay at a lower rate than all others in the same class.

C. Action of the Chancery Court

Pursuant to a petition for judicial review, the Chancery Court of Davidson County affirmed the Public Service Commission. Citing Allied Chemical Corp. v. Georgia Power Co., 236 Ga. 598, 224 S.E.2d 396 (1976), the Court held that the failure of the Commission to follow a cost of service approach "does not make its decision unjust and discriminatory." Further citing the requirement of Section 65-518, T.C.A., that the Commission modify any rates found to be "unjust, unreasonable, excessive, insufficient, or unjustly discriminatory or preferential," the Chancellor noted that CFI "had been obtaining gas at special contract rates lower than other industrial users." The Court held that the Commission's findings were supported by substantial and material evidence.

D. Action of the Court of Appeals

The Court of Appeals for the Middle Section reversed, disagreeing with the Commission and the Chancellor in every material particular. The Court held that (1) the Commission violated Section 4-519, T.C.A., by failing to make findings of fact; (2) that the Commission failed to require and consider cost of service data; (3) that with a general cost of service study there is a reasonable probability that the result would have been different; and (4) that there was no substantial evidence to support the action of the Commission and its action was "discriminatory" and "patently arbitrary."

The thrust of the opinion of the Court of Appeals is that the Commission increased rates to large commercial and industrial users to the exclusion of smaller commercial and residential users "without any evidence to justify the discrimination." The matter was remanded to the Public Service Commission for a "redetermination of rates of the customers of Chattanooga Gas Company," to include small commercial and residential users.

We sustain the Public Service Commission and the Chancellor and reverse the Court of Appeals.

II.

Standard of Review

Section 4-5-117, T.C.A., covers judicial review under the Uniform Administrative Procedures Act. Sub-section (g) provides that review shall be " confined to the record." Sub-section (h) restricts reversal or modification of the agency's decision to those cases where the decision violates constitutional or statutory provisions, or is in excess of the statutory authority of the agency, or is made upon unlawful procedure, and to those instances where the decision is
arbitrary or capricious or characterized by abuse of discretion or clearly unwarranted exercise of discretion; or
unsupported by evidence which is both substantial and material in the light of the entire record.

***540** Further narrowing and restricting the review in the Chancery Court is the statutory command:
In determining the substantiality of evidence, the court shall take into account whatever in the record fairly detracts from its weight, but the court shall not substitute its judgment for that of the agency as to the weight of the evidence on questions of fact. (Emphasis supplied). Section 4-5-117(h) (5), T.C.A.

Thus the UAPA requires that the trial court review factual issues upon a standard of substantial and material evidence. But this is not a broad, de novo review. It is restricted to the record and the agency finding may not be reversed or modified unless arbitrary or capricious or characterized by an abuse, or clearly unwarranted exercise, of discretion and must stand if supported by substantial and material evidence.

[1][2] The same standard of review prevails on the appellate level. We cannot, as a general rule, " afford any broader or more comprehensive review to cases arising under the Act than is afforded to them by the trial court in the first instance . . . ." Humana of Tenn. v. Tenn. Health Facilities Com'n., 551 S.W.2d 664, 668 (Tenn.1977). Further a concurrent finding between the agency and the trial court on any issue of fact is conclusive upon this Court. This Court so held in Blue Ridge Transportation Co. v. Hammer, 203 Tenn. 398, 313 S.W.2d 433 (1958):
Unless there is a plain abuse of discretion by the Commission, its orders will not be disturbed on appeal. And more especially where the Chancellor has considered the record on the common-law writ of certiorari and affirmed the order of the Commission, we feel that this concurrent finding is conclusive of the issue. (Emphasis supplied). 203 Tenn. at 404, 313 S.W.2d at 436.

The Uniform Administrative Procedures Act, to the extent of the standard of review, did not make significant changes in prior decisions and statutory law. In view of the fact that the functions of the Commission are solely administrative or legislative as distinguished from judicial, this Court has consistently held that the review is for the "very limited purpose of determining whether the Commission has acted arbitrarily, or in excess of jurisdiction, or otherwise unlawfully." City of Whitwell v. Fowler, 208 Tenn. 80, 83, 343 S.W.2d 897, 899 (1961).[FN2] This, of course, would require that it be supported by substantial and material evidence.

FN2. See also, Hoover Motor Exp. Co. v. Railroad & Public Util. Com'n., 195 Tenn. 593, 261 S.W.2d 233 (1953), for complete

discussion of the legislative character of the Public Service Commission.

[3] Moreover, under Section 65-520, T.C.A., the power to determine whether rates are "just and reasonable" is reposed in the Commission. There is a presumption that the rates so established are correct and any party who attacks the Commission's findings has the burden of proving that they are illegal or unjust and unreasonable. Southern Bell T. & T. Co. v. Tenn. Pub. Serv. Com'n., 202 Tenn. 465, 304 S.W.2d 640 (1957).

Consideration must also be given to the statutory recognition of the "agency's experience, technical competence, and specialized knowledge." Section 4-5-1097, T.C.A. See also, Blue Ridge Transportation Co. v. Hammer, supra ; Section 65-209, T.C.A.

[4] When the evidence is considered "in light of the entire record," Section 4-5-117(h)(5), T.C.A., and in accordance with the established statutory and decisional law, we find and hold that the Commission's action was supported by ample material and substantial evidence. We have neither the disposition nor the power to substitute our judgment for that of the Commission as to the weight of the evidence on any factual issue. This leaves only questions of law for our determination.

III.

The Sufficiency of the Commission's Finding of Fact

The UAPA provides that:
***541** A final decision shall include findings of fact, conclusions of law, and reasons for the ultimate decision. Findings of fact, if set forth in statutory language, shall be accompanied by a concise and explicit statement of the underlying facts supporting the findings. Section 4-5-113, T.C.A.

[5] This is a statutory imperative; it "is not a mere technicality but is an absolute necessity without which judicial review would be impossible." Levy v. State Bd. of Examiners, Etc., 553 S.W.2d 909, 911 (Tenn.1977).

Able counsel representing CFI earnestly urges that the Commission's order was fatally defective. The Court of Appeals held that the Commission's order " fails to disclose any finding of fact supporting the apparent discrimination against the appellant." The Chancellor, on the other hand, correctly noted that " (t)he purpose of findings and conclusions is to aid the court in determining the reasons behind the agency decision, and whether the agency's conclusion is based on sufficient evidence," and held that "the order . . . reflects findings of fact and conclusions of law which are sufficient to enable this court to review the decision."

[6] The sufficiency of an agency's findings of fact must be measured against the nature of the controversy and the intensity of the factual dispute. It is obvious that where there is no disputed issue of fact and the sole question before the agency is the proper conclusion to be drawn from the undisputed facts and the application of the correct legal rules, the record need not be burdened with detailed findings of fact. In such a case the facts need only be recited.

[7] At the other end of the spectrum are those cases wherein the issues of fact are sharply contested and the proof is conflicting. There a detailed finding of fact dovetailed to the record is a practical and legal imperative. Thus, the nature of the finding necessarily varies from case to case.

The Commission had before it in this case other significant issues which normally carry through to the chancery and appellate review, but which are no longer at issue. Among these was the basic rate increase, an issue separate and apart from rate design. In reaching a decision on this threshold question the Commission was required to consider the rate base, revenues and expenses of the utility, and the significant matter of a fair rate of return based on the petitioner's long term, debt, common equity, and other underlying considerations. These are issues that normally provoke controversy and prompt appeals, and on them the Commission made

detailed findings of fact.

We have examined CFI's 15-point proposed finding of fact filed with the Commission. The first two suggest that the Commission find that CFI is the largest customer of Chattanooga Gas using approximately 30% of the total gas supply. There was no dispute as to this and its inclusion in the finding would have served no useful purpose.

[8] The third proposal related to the uniqueness of the use CFI makes of the gas, a fact that we find to have no material bearing on any issue. Number 4 sets out that the rate originally approved by the Commission was based on a cost of service presentation and was fair and reasonable. Number 5 relates to the original gross profit increases and would have the Commission hold that in the absence of a cost of service study, it cannot ascertain gross profits or the trend thereof in relation to other classes of customers. The original rate has no controlling significance and cost of service is not an exclusive method of determining rate design.

The proposed sixth finding sets forth the reasons Chattanooga Gas has not found it necessary to request a rate increase since 1959. This is argumentative and not of controlling significance. The proposed seventh finding merely relates to an amendment to the pleadings.

The eighth proposal basically relates to an item not allowed by the Commission. The ninth, tenth and eleventh proposals deal with the results of the requested increase.***542** Some of the figures are admittedly incorrect. These three proposals relate basically to discriminatory aspects of the rate design and are argumentative in nature. All concerned knew the end results; there was no basic dispute and its inclusion in the finding would have served no useful purpose.

The twelfth proposal was that Chattanooga Gas had used the intrinsic value approach and the thirteenth asserted a general practice to include a cost of service approach. This is the crux of this controversy and the Commission made full conclusions in this regard. The fourteenth proposal merely argues CFI's insistence that a full cost of service study would substantially decrease its share of any increase. The last proposal urges hardship on farmers and on CFI and is not sufficiently documented to form a basis for a finding.

In summary, the proposed findings incorporate agreed facts, background information, results and argument. Pertinent and essential to this issue are only those relating to cost of service data vis-a-vis intrinsic value. These call for conclusions of law and, as to them, the findings and conclusions contain full discussion.

The primary difficulty in proposing and making findings of fact in this case is that there were no disputed facts pertinent to the issue. Essentially, this controversy raises a single issue, a question of law, viz.: May the Public Service Commission adopt a rate design without having before it for consideration a cost of service study? [FN3] A secondary issue relates to a charge of discrimination against CFI.

> FN3. Counsel for CFI made it clear in beginning colloquy that the controversy was "basically in the area of allocation of cost of service to different customers, and the rate structure as to who is going to bear the burden."

[9] We hold, in the context of this case, that the Commission's finding was adequate and proceed to discuss the controlling questions of law.

IV.

Cost of Service versus Intrinsic Value

[10] The polestar of public utility rate establishment and regulation is the "just and reasonable" requirement of Section 65-518, T.C.A. There is no statutory nor decisional law that specifies any particular approach that must be followed by the Commission. Fundamentally, the establishment of just and reasonable rates is a value judgment to be

made by the Commission in the exercise of its sound regulatory judgment and discretion.

Specifically, there is no requirement in any rate case that the Commission receive and consider cost of service data, or that such data, if in the record, are to be accorded exclusivity. It is self-evident that cost of service is of great significance in the establishment of rates but is of lesser value in arriving at rate design. A fair rate of return to the regulated utility is one thing; the establishment of rates among various customer classes is quite another.

Moreover, the intrinsic value of the service rendered, while not controlling, is a proper element of consideration and is, perhaps, of more value in establishing rates among customers than in determining a fair rate of return to the utility itself.

The criteria by which the Commission should be guided have received only generalized comments in our reported decisions. This is proper because the courts are playing a limited role in reviewing actions which essentially are legislative in character. Rate making is not a judicial function and we accord the Commission great deference in reviewing its decisions. On fixing rates in general the Court has spoken in terms of what is just and reasonable "under the proven circumstances," of " regard to all relevant facts" and to a rate "in the zone of reasonableness." Southern Bell Telephone & Telegraph Co. v. Tennessee Public Service Com'n., 202 Tenn. 465, 304 S.W.2d 640 (1957).

The Uniform Administrative Procedures Act authorizes the agency to take notice of "generally recognized technical and scientific***543** facts within the agency's specialized knowledge," and in the evaluation of evidence the agency is specifically authorized to utilize its "experience, technical competence, and specialized knowledge." Section 4-5-1097, T.C.A.

[11] Thus, the Public Service Commission in rate making and design cases is not solely governed by the proof although, of course, there must be an adequate evidentiary predicate. The Commission, however, is not hamstrung by the naked record. It may consider all relevant circumstances shown by the record, all recognized technical and scientific facts pertinent to the issue under consideration and may superimpose upon the entire transaction its own expertise, technical competence and specialized knowledge. Thus focusing upon the issues, the Commission decides that which is just and reasonable. This is the litmus test nothing more, nothing less.

In United Inter-Mountain Telephone Co. v. Public Service Com'n, 555 S.W.2d 389 (Tenn.1977), this Court noted that "(t)he impact of the Administrative Procedures Act on the review of the decisions made by state boards, commissions and agencies, including the Public Service Commission, is massive " (emphasis supplied), and pointed out that "(i)t casts upon the Commission the heavy burden of a sound, reasoned, and judicious approach in the exercise of its jurisdiction." 555 S.W.2d at 392.

We reiterate that neither the legislature nor the courts have established any precise formula or yardstick to guide the Commission. As pointed out by the Georgia Supreme Court in Allied Chemical Corp. v. Georgia Power Co., 224 S.E.2d 396 (Ga.1976):
The process of setting rates is not required to follow any particular course, so long as the end result does not violate the "just and reasonable requirement" requirement . . . . 224 S.E.2d at 399.

The Oklahoma Supreme Court, in Application of Arkansas Louisiana Gas Co., 558 P.2d 376 (Okl.1976), pointed out:
Commission is not bound by a single formula or a combination of formulas in fixing rates and none is exclusive or more favored than the others. (citation omitted) There is no precise statutory or court announced basis for determining the justness or reasonableness of class rate level structures or relationships, the Court generally holding that rate making is the responsibility of a regulatory commission effectively exercising its discretion upon sufficient evidence before it. 558 P.2d at 379.

Finally, we adopt the concise and correct

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conclusions of the Minnesota Supreme Court in St. Paul Area Chamber of Commerce v. Minnesota Public Service Com'n., 312 Minn. 250, 251 N.W.2d 350 (1977):

(W)e must presume that the members of the commission itself, with their supporting staff, have in their grasp practical knowledge in the field of utilities regulation not possessed by either the courts or laymen in general.

The commission, in order to carry out its mandate from the legislature to establish "just and reasonable " rates, must be able to draw on its own internal sources of knowledge and experience. As with the legislature itself, we assume that it does so in each instance and that we ought not to interfere unless it should clearly exceed its statutory powers. 251 N.W.2d at 354.

[12] We cannot say on this record that the Commission exceeded its regulatory judgment and discretion in acting without a cost of service study in a rate design case. The imposition of this requirement would be an unwarranted intrusion into the rate making process.

The record shows that the Commission reached a result that was just and reasonable and equitable.

V.

Discriminatory Rate Structure

CFI contends that the Commission acted discriminatorily and without any rational basis in imposing a rate increase on "743 ***544** large users to the exclusion of the 25,000 smaller users" without any evidence to justify the discrimination." The Court of Appeals so held.

We should point out at the onset that 742 of the 743 large users have voiced no complaint.

The following tabulation is significant:

	Net Increase	Increase	Consumption	Generated Gross Profit
CFI	$394,866	43.4	34.1%	15.7%
742 others	515,360	56.6	56.6	65.2
25,000 residential	-0-	-0-	9.3	19.1

Thus, it will be seen that while CFI buys approximately one-third of the total output of Chattanooga Gas, it accounts for only 15.7% of the profit. It uses almost four times as much as the 25,000 residential customers but contributes less to gross profit. The 742 other industrial users consume 22.5% more gas than CFI, but contribute 49.5% more to the gross profit.

Additionally, as found by the Commission, CFI pays $1.35 per McF, while the 742 other industrial users pay $1.46, and is "receiving gas at bargain rates."

But this is not the discrimination that CFI has in mind. Its insistence and that of the Court of Appeals was that exempting the 25,000 residential customers from the increases was discriminatory. It was apparently the view of the Court of Appeals that when the rates charged one class of customers are raised, all others must also be raised. This does not necessarily follow.

[13] There was no pleading or procedural predicate in this case which would have justified a revision of residential rates. Remanding this case to the Commission to adjust the rates of residential customers is beyond the purview of judicial review. The sole concern of the courts, at each stage of appellate review, is to determine whether the Commission's action on the matters raised by the application meets the requirements of the law. Rate making is not a judicial function and the courts are powerless to remand for the determination of a new cause of action.

[14] If the Commission's action was invalid in that the rate design approved was discriminatory and without rational basis, the only appellate remedy is to strike the increase, in whole or in part, or remand for reconsideration of the respective rights of the contending parties.

The fact that residential consumers pay at a lesser rate is of no patent significance. Utilities traditionally have charged differing rates among classes of customers. Many factors enter into the determination of rates among classes of consumers. This record is silent in this regard and we will not assume from a silent record that there is no material basis for the differing rates.

[15] Section 65-518, T.C.A., gives the Public Service Commission the express power to adjust rates that are "unjust, unreasonable, excessive, insufficient or unjustly discriminatory or preferential." Again, we are not willing to assume from an incomplete record that the Commission deviated from its sworn duty; to the contrary, we presume its compliance. We are unwilling to hold, in the posture of this case, that the Commission established unjustly discriminatory or preferential rates.

[16] While we hold, without hesitation or equivocation, that a public utility may impose differing rates among customer classes, we do not deem it necessary or proper to explore or delineate the criteria that must be met.

We are content to rest our holding on the lack of pleading and procedural predicate for a consideration of the issue involving the residential customers. The discrimination involving the remaining industrial users may be more apparent than real. In any event, their situation is not presented for review.

The judgment of the Court of Appeals is reversed; the Trial Court and the Public Service Commission are affirmed.

BROCK, C. J., FONES and HARBISON, JJ., and BLACKBURN, Special Justice, concur.
Tenn., 1980.
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BEFORE THE TENNESSEE PUBLIC SERVICE COMMISSION

Nashville, Tennessee
August 20, 1993

IN RE: EARNINGS INVESTIGATION OF SOUTH CENTRAL BELL TELEPHONE COMPANY, 1993-1995
DOCKET NO. 92-13527

PETITION OF BELLSOUTH TELECOMMUNICATIONS, INC., D/B/A SOUTH CENTRAL BELL TELEPHONE COMPANY FOR CONDITIONAL ELECTION OF REGULATION PURSUANT TO CHAPTER 1220-4-2-.5 OF THE TENNESSEE PUBLIC SERVICE COMMISSION'S RULES AND REGULATIONS
DOCKET NO. 93-00311

ORDER

This matter is before the Commission pursuant to the Staff investigation concluding that South Central Bell Telephone Company should reduce its earnings[1] during the 1993-1995 period. See T.C.A. § 65-2-106 and § 65-5-201.

The investigation began in early 1992 and over the succeeding months the Company submitted voluminous information concerning its operations in response to Staff Requests and on its own initiative. The parties in these cases have served data requests and received responses to those requests. This information, and all of the evidence presented at the hearings on April 6 and 7, 1993, comprise the record before this agency. Based on that record, the Commission adopts the Findings of Fact and Conclusions of Law set forth below:

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[1] See attached Appendix A itemizing the differences between the Staff's presentation and the Company's projections of earnings during the forecast period.

I. RATE OF RETURN/CAPITAL STRUCTURE

The Staff recommends 12 percent as a reasonable return on equity. The Staff further recommends an overall return on rate base of 10.26 percent. This return is based on the Staff's proposal for a double-leverage capital structure.

The Company asked for a continuation of its 11.6 percent overall return granted in 1990. This implies an approximate 14 percent return on equity. The Company recommends use of its actual capital structure.

a. Capital Structure

Until the first day of the hearing (April 6), capital structure was not a contested issue in this case. The Staff and the Company agreed that the Company's actual capital structure (33.41% long term debt, 5.11% short term debt, and 61.48% common equity) was appropriate for ratemaking purposes. This agreement was supported by Staff witness Klein in his direct and rebuttal testimony and by several facts: first, that the Company's actual capital structure remained very stable over the course of the initial regulatory reform plan; second, the actual capital structure reflects the realities of the Company's financial situation; and finally, the recent regulatory practice of this Commission has been to use the Company's actual capital structure.

Dr. Klein in his surrebuttal testimony on April 6 recommended the use of a "double leverage" capital structure. This recommendation changed the earlier Staff position that had accepted the Company's capital structure.

The source of the revised Staff recommendation is the guarantee by BellSouth (the parent of the Company) of debt which supports an Employee Stock Ownership Plan. The Staff recommends recognition of this debt in the Company's capital structure. The Company opposes this recommendation, citing Dr. Klein's original reasoning and additionally presenting evidence that the Staff recommendation would unnecessarily penalize the Company for the tax savings associated with the debt, which is already accounted for through the Company's compensation expense accounting.

The Commission has used double-leverage capital structures in setting rates for other utilities, and such findings will continue to be made where appropriate. In light of the specific evidence in this case relating to this Company's capital structure, however, we find that the Company's actual capital structure is appropriate for the 1993-95 plan for the Company.

b. Authorized Rate of Return Range

Testimony on the required return on equity was presented by a Staff witness, Dr. Klein, and a witness presented by the Company, Professor Vander Weide. These witnesses disagreed on at least three points: (1) Dr. Klein's use of the annual Discounted Cash Flow (DCF) model as opposed to the quarterly DCF model used by Professor Vander Weide; (2) Dr. Klein's use of short term U. S. Treasury bills for the risk premium analyses versus Professor Vander Weide's use of long term corporate bonds; and (3) the selection of firms for the analysis of required return on equity.

In addition to witnesses Klein and Vander Weide, the Staff and Company presented differing views of the competitive risk

that will be faced by the Company over the next three years. The Staff contends that Company financials indicate that the risk facing the Company from competition is minimal over the next three years, while the Company contends that the risk is clearly greater. The Company asserts that the threat of local competition from co-locators, cable television companies, and wireless companies has contributed to increase the Company's risk, and consequently its required return.

In considering all of the evidence, the Commission finds that a range of return on rate base of 10.65% to 11.85%, with a mid-point of 11.25%, is just and reasonable.

II. USE OF THE FORECAST

The regulatory reform rule requires that we project Bell's earnings over a forecast test period of two to four years. Both Bell and the Staff have provided us with forecasts of each of the next three years.

The Staff and Bell have different opinions as to how the forecast should be used. The Staff proposes that we use the forecast as we did in 1990, when we took each of the three years and ordered in advance three separate rate adjustments, after which we allowed the sharing matrix to make any other adjustments.

The only sharing which occurred was "negative" as Bell was unable to achieve the targeted rate of return in any of the three years of the plan, and fell below the authorized range of 11% to 12.2% in the latter two years.

Bell's proposal in this case is to make a different use of the forecast than that made in 1990. Bell proposes that only the first year of the forecast be used to set rates. If the first year forecasted rate of return is outside the rate of return range, rates will be adjusted to the nearest end of the range. If the forecasted rate of return does not fall outside of the range, no rate adjustment will be made. After the initial rate adjustment, the sharing matrix would be used to determine the funds available for future rate adjustments.

Both the Staff and Bell, as expected, criticize each other's positions. The Staff says Bell's plan causes earnings to accrue to the company which should be used for rate reductions or for the accelerated deployment of technology, and that Bell ignores the second and third years of the forecast. Bell criticizes the Staff plan as one which is more draconian than traditional regulation because it eliminates any possibility of the Company's sharing in efficiencies as spurred by an incentive regulation environment and limits the Company to sharing only 40-60% of any "extra" efficiencies; under traditional regulation the Company claims it would retain 100% of the extra efficiencies. In addition, Bell claims the Staff plan is flawed because it relies on speculative "out year" forecasts for some of its rate adjustments, rather than relying on actual results.

The contention over use of the forecast in the renewal of incentive plans requires resolution. Our regulatory reform rule requires us to make a multi-year forecast, but it does not require any particular use of the forecast. In fact, the rule

states clearly that "all or part" of projected earnings above the prescribed return may be placed in a deferred revenue account "in appropriate circumstances." Accordingly, we are free to tailor the incentive renewals in a way that will best serve the public interest.

The Staff has raised a legal issue regarding Bell's proposal. The Staff argues that a three year forecast must be utilized to set rates so that all "known and reasonably anticipated" changes are taken into account in setting rates.

We are satisfied that the law allows the Commission the discretion to use a forecast test period, a historical test period, or any other accepted method to determine a fair rate of return.

Both the Company and the Staff have proved that forecasting the results of the "out" years (i.e., the second and third years of the forecast) is a problematic exercise. Neither party predicted with any precision in 1990 what actually happened in 1991 and 1992. The causes of the misses cannot be, and probably could never be, identified with certainty. Changes in Tennessee's and the nation's economies, rapid technological change, increasing competition, and regulatory changes could have contributed to the inaccuracy of these predictions.

Whatever the cause may be, however, the potentially perverse results should be avoided. For example, Bell in 1991 earned below the range of 11-12.2% which was determined reasonable by this Commission. Yet the 1990 order mandated a rate

reduction/deferred revenue account (DRA) contribution of $74.0 million in 1992 despite the underearnings in 1991. Continuation of a policy similar to that which we started in 1990 could, if forecasts continue to be missed, result in rate decreases for companies that need rate increases, and rate increases for companies that are overearning. While our 1990 policies may have been correct in starting regulatory reform, we will not continue a policy that could have such contrary results. In the future, rate adjustments and Deferred Revenue Account contributions flowing from the Company's regulatory reform plan will be based only on actual results. Use of actual results will allow us to take into account all changes, known or unknown, reasonably anticipated or ignored by any forecast.

Basing future adjustments only on actual results is also consistent with our view of how regulatory reform ought to work. Companies that have been operating under a Regulatory Reform Plan have made decisions for which they should bear at least part of the potential consequences and reap at least part of the potential rewards. By focusing only on actual results, the Company will share in the consequences of earnings outside its authorized rate of return range, and will not be shielded or disincented from those consequences by a stale and speculative forecast adjustment.

In considering all of the evidence, the Commission finds that it is reasonable to adopt the Company's recommendations respecting use of the forecast.

III. FORECAST/ACCOUNTING/REGULATORY ISSUES

The Staff and the Company differed greatly in their respective predictions of the next three year's performance of the Company.

The difference in calculations of historical returns were not as great. Both the Staff and the Company presented evidence that the overall return was between 11.18% and 11.34% in 1990, and between 10.5% and 10.96% during 1991 and 1992.

The 1993 forecast filed by the Company predicts an 11.45% return on rate base. The Staff forecasts a return of 14.06%.

The trend shown above by actual results speaks for itself. We find the Company forecast to be more in line with the trend from previous actual results. Accordingly, we accept the use of the Company's forecast, by each component and in total, with the following exceptions and explanations:

(a) Inside Wire

The Staff proposed to treat the maintenance plan payment option for inside wire maintenance service as an above the line item, while recommending that maintenance paid for on a "time and materials" basis and installation should be below the line items. The Staff believes that the maintenance plan activity is unique and not subject to competition, but believes that installation is a competitive business.

In response to the Staff's position, the Company states that if part of the inside wire business is to be imputed, then the whole business should be imputed. The Company expresses a preference for accounting for all inside wire operations below the line, which will remove all inside wire revenues and expenses from ratemaking and would leave the Company free to set any price it wants for any of the services. Thus, the sum of the Company's position is that the entire inside wire business should be treated as a whole, either above or below the line. In particular, the Company contests the Staff position that maintenance is a separable activity; the Company contends that maintenance is a single activity with two payment options. Recognizing the Commission's history of imputing total inside wire operations in 1990-92, the Company filed tariffs for the installation and maintenance of inside wire. The Company states that if inside wire operations are to be imputed, then it favors formalizing the process through tariffing.

While there is disagreement over how the revenues and expenses should be treated, there is agreement that the total inside wire operations of the Company are losing money. Based upon records submitted by the Company, the Staff calculates that the maintenance plan service of Bell loses approximately $200,000 per year. The Staff also calculates much larger losses on the time and materials maintenance and installation segments of the inside wire business. The Commission finds that the inside wire operations of the Company are losing money as a whole, and that

each of the components of the inside wire line of business are losing money.

While inside wire has existed in a turbulent regulatory environment for many years, it is now clear that the FCC acquiesces in state decisions to account for inside wire operations either above or below the line in setting rates and regulating those operations. The FCC and many other states require that inside wire operations be accounted for below the line. Given our clear flexibility, and the evidence of competition in the inside wire business, we believe it is appropriate to end inclusion of the inside wire business in the calculation of the Company's revenue requirement.

Accordingly, we require the Company to account for all inside wire operations below the line and we deny the tariff filed by the Company. It is necessary, however, to continue the exercise of our jurisdiction with respect to the price and service rendered pursuant to the Company's monthly maintenance plan. In order to maintain reasonable rates for monthly inside wire maintenance services, we require the Company to maintain the current price of $1.25 per month through the end of 1993. In 1994, the Company may raise the price to and including $1.75 per month. In 1995, the Company may increase the price above $1.75 by no more than 10%, and the Company will be limited to an increase of 10% per year thereafter. In addition, we will continue to exercise jurisdiction over complaints regarding the maintenance service rendered by the Company.

(b) L.M. Berry Adjustment

In the 1990 case, the Staff recommended, and the Commission adopted, an adjustment to the Company's revenue requirement based on the difference between new and old contracts that BAPCO had with L.M. Berry.

BellSouth acquired L.M. Berry in 1986. Prior to the acquisition, L.M. Berry had performed yellow pages advertising sales services for South Central Bell. The contract negotiated with South Central Bell in the 1970s provided for the payment of certain commissions to L.M. Berry for its efforts. In 1989, L.M. Berry and BAPCO entered into an agreement which the Staff found resulted in a higher percentage of commission payments to L.M. Berry. The Staff recommended we disallow the difference in the two contracts, and the Commission adopted the Staff recommendation. Accordingly, the revenue requirement for the 1990 through 1992 period reflected this adjustment. The basis for the Commission's decision was a lack of evidence on the part of the Company justifying the change in the commission rate. The Commission was presented with no evidence that L.M. Berry had a similar rate with companies similar to South Central Bell.

In this case, however, the Company did present similar contracts to the Staff for review. The Staff continued to recommend that we disallow the difference. We find, however, that the evidence presented by the Company supports its contention that similar commission rates are paid to L.M. Berry by telephone companies of similar size and influence.

Accordingly, the Commission orders that the disallowance respecting the L.M. Berry contract be discontinued.

(c) BAPCO Rate Base/Yellow Page Revenue Growth[2]

1. Yellow Page Revenue Growth

The Staff forecasted yellow and white page directory advertising revenue to be $288.1 million using an average growth rate of 8.4%. The Company projected these same revenues to be $262.8 million using an average growth rate of 3.6%.

	Staff	Company	Difference
Yellow Page Publishing Fee	$189.0	$166.7	$22.3
BAPCO Yellow Page Rev.	63.5	59.4	4.1
White Pages	35.6	36.8	-1.2
Total Directory Rev.	$288.1	$262.9	$25.2

Company witness Cochran stated in his rebuttal testimony that only the $22.3 million difference in the Yellow Page publishing fee remains an issue. Therefore, the Company apparently accepts the Staff's numbers on White Pages and BAPCO revenue.

The Company's only argument on the publishing fee revenues is that the Staff used too high a growth rate. Staff witness Gaines explained that his forecast of revenues was made using an average growth rate which considered that the individual components making up the Directory Revenue account grow at

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[2] This is actually a "forecast" rather than an "accounting" issue but is included here because it relates to BAPCO and the proper amount of the Yellow Page imputation.

different rates. He pointed out that the Company only chose to take issue with the one area of this account where the Staff's forecast was higher than the actually achieved rates. As an example, he pointed out that BAPCO Tennessee Net Income had actually grown at an average annual rate of 16.3% -- not the 9.2% used in the Staff's forecast. Therefore, he stated that the growth of one component of the account should not be changed unless the growth in the other areas is also adjusted. To emphasize this, Staff witness Gaines indicated that he had arrived at virtually the same Directory Revenue forecast by pricing out the individual components at the individual growth rates.

Staff witness Gaines also pointed out that his methodology for forecasting the Yellow Pages revenues had been found reasonable by BAPCO and may well be conservative since BAPCO itself refused to tell the Staff what price increases BAPCO expected to make during the 1993-95 period. Finally, Staff witness Gaines stated, and Company witness Cochran confirmed on cross examination, that BAPCO itself failed to provide any workpapers to support the growth rate used in the Company's forecast.

Based on the lack of documentation supporting the Company's Yellow Page revenue and the Staff's ability to demonstrate that using individual growth rates produces approximately the same revenues as the average growth rate, the Commission adopts the Staff's projected Directory Revenues of $288.1 million for 1993-1995.

2. BAPCO Rate Base Addition

The Staff's rate base addition for BAPCO's Tennessee Yellow Page operations is $28.2 million less than the Company's rate base addition. The revenue requirement of this issue is $4.0 million for the three years.

Staff witness Gaines pointed out in surrebuttal testimony that the Staff's rate base addition is less than the Company's because Bell's figures reflect investment while the Staff's figures reflect equity. The Company presented no evidence to support its position which, in any event, is not consistent with prior Commission decisions on this issue. Therefore, the Commission adopts the Staff's BAPCO rate base addition of $75.2 million for 1993-1995.

(d) Other Disallowances

In addition to the BAPCO and L.M. Berry disallowances discussed above, the Commission has in previous cases ordered various disallowances that have been reflected in the Company's earnings. The Company's forecast was computed using the Commission's methods. The Staff proposed an increase in the percentages applied in computing the disallowance for certain lobbying and advertising expenses. The Commission finds that the other disallowances as computed by the Company are appropriate, and, accordingly, no change is required.

(e) Conclusion

Our rulings on the L.M. Berry issue discussed in (b) above and the BAPCO issues discussed in (c) above have only a slight impact (See Appendix A, page 1) on the Company's forecast

of an 11.45 percent return on rate base for 1993. After the change made for Inside Wire, the forecasted return for 1993 is approximately 11.75% and thus falls within the rate of return range approved in this Order. Accordingly, no rate adjustment based on the forecast is ordered.

IV. RATE DESIGN

a. Cap for Local Residential and Business Rates

The Commission finds that it is just and reasonable and in the public interest to cap the current rate levels for basic flat rate local residential and business services.

b. Optional Calling Plans

The Commission finds that it is in the public interest to create optional calling plans for calls within a 40-mile radius of the customer's serving wire center. South Central Bell is hereby ordered to develop and submit such plans to the Commission by March 31, 1994. The plan shall be submitted on a revenue neutral basis.

c. Rate Changes to Be Funded From the Deferred Revenue Account

The Commission established a deferred revenue account in the 1990 regulatory reform order adopted for South Central Bell. Although the legal status of that deferred revenue account has been in question because of the Tennessee Court of Appeals decision on appeal of that Order, the Company committed to

maintain a deferred revenue account whose balance would be based on the rate reductions/deferred revenue account contributions flowing from the 1990 Order. The new regulatory reform rule adopted in January, 1993, allows for creation and maintenance of a deferred revenue account. The Commission has adopted, in another docket, a motion that establishes the deferred revenue account and balance for that account based on the Company's commitment.

Accordingly, the Commission finds and orders that the Company maintain the deferred revenue account established by the Commission for the period January 1, 1993 through December 31, 1995. Based on the record before it, the Commission finds and orders that the deferred revenue account be used for the following rate adjustments:

(1) Access/Toll Reductions

The Commission finds that it is in public interest to reduce South Central Bell's access rates by an amount that will allow long distance companies to reduce their toll rates to interstate levels, and to reduce South Central Bell's toll rates consistent with the method used to reduce toll rates in Docket 89-11065. This action continues the Commission's consistent practice of reducing toll rates to all Tennessee customers and moving access rates closer to parity with interstate rates. The Commission intends to continue this practice as appropriate opportunities present themselves. Accordingly, effective September 1, 1993, the Company is hereby required to reduce switched access rates by an amount which will allow long distance companies to reduce

their intrastate toll rates to currently effective interstate levels, and to reduce South Central Bell's toll rates consistent with the method used in Docket No. 89-11065, and the funds for these reductions will be drawn annually from the deferred revenue account. AT&T, the state's dominant interlata carrier, shall flow through, on a dollar-for-dollar basis, these access reductions to their customers.[3]

(2) County Wide Calling

The Commission finds that it is in the public interest to complete county wide calling in Tennessee. To the extent that there are any counties where county wide calling without toll charges is not available, the Company will file tariffs to accomplish such county wide calling, and the funding required to provide such county wide calling will be drawn from the deferred revenue account.

(3) Depreciation

The three-way meeting between the Staffs of the FCC and this Commission and the Company was held April 5, 6, 1993. Agreement has now been reached between the Company and the Staff respecting the capital recovery program for the Company. The Company is hereby ordered to implement the depreciation schedules attached as Appendix B effective September 1, 1993. The funding for 1993 shall be drawn from the deferred revenue account. The funding

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[3] AT&T shall reduce its intrastate rates so that they are no higher than the comparable interstate rates. Any intrastate rates which are currently below the comparable interstate rates are not affected by this Order.

for 1994 and 1995 will be drawn from the deferred revenue account and such deferred revenue account will include any applicable accruals for sharing associated with 1994 and 1995 results. If, at the end of 1995, the Company has recorded changed depreciation expense[4] for the combined years of 1994 and 1995 in excess of the sum of all sharing amounts attributed to customers during those two years, the Company shall contribute the amount of such excess, with appropriate interest, to the deferred revenue account.

(4) Dickson County

The Dickson County Chamber of Commerce was an intervenor in this proceeding. Its witness, Richard Bibb, requested that Dickson County be added to the Metro Area Calling (MAC) area. Dickson County was not included in the MAC plan for Nashville originally because Dickson County is not a county contiguous to Davidson County. Dickson County argues that it is in the Metropolitan Statistical Area (MSA) for Nashville, and that it ought therefore to be included in the MAC plan for Nashville.

After consideration of the evidence on this issue, the Commission finds that Dickson County should be included in the Metro Area Calling area for Nashville. The Company is hereby ordered to include Dickson County in the Nashville Metro Area

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[4] "Changed depreciation expense" is the difference between the actual revenue requirement calculated using the previous depreciation rates and the actual revenue requirement calculated using the depreciation rates adopted in this order.

Calling area effective January 15, 1994, and the funding shall be drawn from the Deferred Revenue Account.

V. PETITION FOR RECONSIDERATION

Any party aggrieved with the Commission's decision of this matter may file a Petition for Reconsideration with the Commission within ten (10) days from and after the date of this Order.

VI. JUDICIAL REVIEW

Any party aggrieved with the Commission's decision of this matter has the right of judicial review by filing a Petition for Review in the Tennessee Court of Appeals, Middle Section, within sixty (60) days from and after the date of this Order.

IT IS SO ORDERED, this 20TH day of August, 1993.

CHAIRMAN

COMMISSIONER

COMMISSIONER

ATTEST:

EXECUTIVE DIRECTOR

South Central Bell
Revenue Requirement of Rate Review Issues
1993 Forecast Year Based on Single-Year Methodology
(Millions)

		Approximate Amounts
COMPANY METHODOLOGY FOR PLAN IMPLEMENTATION	A/	-2.5
RATE OF RETURN:		
ESOP Debt (ROR 10.35% to 10.26%)		2.2
Updated Feb Debt Cost Interest Synch		-0.4
Change in Rate of Return - 11.6% to 10.06%		33.6
Total Rate of Return		35.4
ACCOUNTING/REGULATORY ISSUES:		
Inside Wire		6.1
Pension		9.5
OPEBS		1.5
Disallowances		0.6
BAPCO Rate Base		1.2
LM Berry		2.4
ESOP (Interest Synchronization)		2.0
Total Accounting/Regulatory Issues		23.3
FORECAST ISSUES:		
Local Revenues		5.3
Access Revenues		1.8
Long Distance Revenues		-0.2
Miscellaneous Revenues		0.6
Uncollectible Revenues		1.7
Total Revenue Issues		9.2
Salary & Wage Expenses		9.2
Other O & M Expenses		10.6
Other Taxes		-1.6
MemoryCall		2.3
BAPCO Income		0.2
Def'd FIT		-0.3
Other		4.6
Total Expense/Other		25.0
GRAND TOTAL		90.4

A/ Difference in Company proposed Plan to continue the incentive plan methodology with sharings above 12.2% versus the Staff's proposed continuation with rate reductions down to 11.6%. (See Note A/ on the 3 year forecast sheet).

Note 1: The above quantifications have been developed by the Staff and include the Staff's proposed rate of return of 10.06%. The Company and Staff agree that a different rate of return will cause the value of the accounting issues to be different than the amounts listed above. This difference would not be expected to significantly change the quantification of those issues.

Note 2: The Staff's use of a 10.06% rate of return if a single year review period is utilized to set revenue requirements is different than the 10.26% rate of return that was utilized in the quantification of issues over the three-ye period of 1993-1995. However, neither the Company nor the Staff recommended a one-year review period.

South Central Bell
Revenue Requirement of Rate Review Issues
Three Year Forecast
(Millions)

	Approximate Amounts
COMPANY METHODOLOGY FOR PLAN IMPLEMENTATION A/	46.6
RATE OF RETURN:	
ESOP Debt (ROR 10.35% to 10.26%)	6.3
Updated Feb Debt Cost Int Synch	-1.2
Change in Rate of Return - 11.6% to 10.35%	87.8
Total Rate of Return	92.9
ACCOUNTING/REGULATORY ISSUES:	
Inside Wire	22.0
Pension	27.6
OPEBS	2.5
Disallowances	1.7
BAPCO Rate Base	4.0
LM Berry	8.0
ESOP (Interest Synchroniztion)	7.4
Total Acoounting Issues	73.2
FORECAST ISSUES:	
Revenues:	
Local	12.0
Access	4.9
Long Distance	2.9
Miscellaneous	10.7
Uncollectibles	5.4
Total Revenue	35.9
Expenses:	
Salaries & Wages	21.2
Other O & M Expenses	59.6
Other Taxes	1.3
MemoryCall	3.3
BAPCO Income	4.1
Def'd FIT	2.5
Other	6.4
Total Expense/Other	98.4
GRAND TOTAL	347.0

A/ (Staff Calculated excess based on amount above 11.6% using the Company's forecast for 1993-1995.) Difference in Company's proposed continuation of the incentive plan methodology (i.e., based upon 1 year forecast with rate reductions in years 2 and 3 based upon actual results) and the Staff's proposed continuation of the incentive plan methodology (i.e., based upon a 3 year forecast with rate reductions in years 2 and 3 based upon forecasted results presented in the hearings).

Note: The above quantifications have been developed by the Staff and include the Staff's proposed rate of return of 10.26%. The Company and the Staff agree that a different rate of return will cause the value of the accounting issues to be different than the amounts listed above. This difference would not be expected to significantly change the quantification of those issues.

Run Date : 04/19/93 - 07.54.45
Report : STM-A-RL, PSC_3WAY
Proposed

Company : BellSouth Telecommunications
State : Tennessee
Statement A - Remaining Life

Summary of Changes in Depreciation Rates

Account Number	Class or Subclass of Plant	Rates in Effect: RL Life Years	Rates in Effect: Reserve Percent	Rates in Effect: Future Net Salv	Rates in Effect: Depr. Rate %	Rates Effective 1993: RL Life Years	Rates Effective 1993: Reserve Percent	Rates Effective 1993: Future Net Salv	Rates Effective 1993: Depr. Rate %
		A	B	C	D	E	F	G	H
2112.00	Motor Vehicles	4.2	42.1	16	10.0	3.7	52.5	16	8.5
2115.00	Garage Work Equipment	13.1	24.8	-1	5.8	13.3	9.4	-1	6.9
2116.00	Other Work Equipment	13.1	24.8	-1	5.8	12.6	30.7	-1	5.6
2121.00	Buildings	30.0	26.2	1	2.4	29.0	28.9	1	2.4
2122.00	Furniture	11.0	29.4	9	5.6	10.1	24.0	9	6.6
2123.00	Office Equipment	3.9	19.6	28	13.4	3.9	21.3	28	13.0
2124.00	Genl Purpose Computers	3.6	71.3	2	7.4	3.8	38.8	2	15.6
2211.00	Analog ESS	3.6	52.8	3	12.3	2.0	71.7	3	12.7
2212.00	Digital ESS	12.2	20.1	5	6.1	10.3	23.0	4	7.1
2220.00	Operator Systems	7.7	37.2	5	7.5	7.7	46.5	5	6.3
2231.00	Radio Systems	7.8	31.1	0	8.8	8.0	53.8	0	5.8
2232.00	Circuit-Other	6.2	36.4	2	9.9	5.8	43.6	0	9.7
2232.11	Circuit-DDS	4.4	42.1	10	10.9	4.1	48.1	2	12.2
2311.00	Station Apparatus	4.6	7.4	4	19.3	3.2	60.2	4	11.2
2341.00	Large PBX	4.6	10.8	-4	20.3	3.3	45.7	-4	17.7
2351.00	Public Telephone	3.8	48.4	20	8.3	2.9	60.5	20	6.7
2362.00	Other Terminal Equip.	3.2	60.0	3	11.6	3.0	66.8	3	10.1
2411.00	Poles	23.0	44.9	-48	4.5	22.0	43.8	-48	4.7
2421.10	Aerial Cable Metal	12.7	38.0	-15	6.1	10.8	44.6	-15	6.5
2421.20	Aerial Cable Fiber	20.0	15.0	-20	5.3	20.0	10.8	-20	5.5
2422.10	Undergrd Cable Metal	17.0	33.5	-9	4.4	14.4	41.9	-8	4.6
2422.20	Undergrd Cable Fiber	19.2	19.1	-20	5.3	18.9	19.0	-20	5.3
2423.10	Buried Cable Metal	13.6	35.3	-5	5.1	11.5	41.6	-5	5.5
2423.20	Buried Cable Fiber	13.1	32.5	-9	5.8	14.6	25.1	-9	5.7
2424.00	Submarine Cable	15.4	43.6	-1	3.7	13.6	40.2	-1	4.5
2426.00	Intra-Bldg Netwk Cable	13.6	24.8	-10	6.3	12.5	37.1	-10	5.8
2431.00	Aerial Wire	14.5	71.0	-40	4.8	14.1	74.8	-40	4.6
2441.00	Conduit System	49.0	21.7	-5	1.7	46.0	23.2	-5	1.8
Composite Rate					6.7				7.2

Run Date : 04/19/93 - 07.54.45
Report : STM-B-SP, PSC_3WAY
Proposed

Company : BellSouth Telecommunications
State : Tennessee
Statement B - RL Separated

Change in Annual Depreciation Expense
Resulting from Changes in Depreciation Rates and Amortization
(Separated on an INTRASTATE basis)
(000)

Account Number	Class or Subclass of Plant	INTRASTATE Separations Factor	Investment 1-1-93		Rates in Effect		Rates Effective 1993		INTRASTATE Change in Expense
			Combined	Separated	Combined	Separated	Combined	Separated	
		Q	R=I	S=Q*R	T=L	U=Q*T	V=O	W=Q*V	X=W-U
2112.00	Motor Vehicles	.766	58,066	44,479	5,807	4,448	4,936	3,781	-667
2115.00	Garage Work Equipment	.766	1,687	1,292	98	75	116	89	14
2116.00	Other Work Equipment	.766	31,644	24,239	1,835	1,406	1,772	1,357	-48
2121.00	Buildings	.766	208,632	159,812	5,007	3,835	5,007	3,835	0
2122.00	Furniture	.766	2,601	1,993	146	112	172	132	20
2123.00	Office Equipment	.766	7,340	5,622	984	753	954	731	-22
2124.00	Genl Purpose Computers	.766	140,915	107,941	10,428	7,988	21,983	16,839	8,851
2211.00	Analog ESS	.838	239,868	201,010	29,504	24,724	30,463	25,528	804
2212.00	Digital ESS	.838	539,766	452,324	32,926	27,592	38,323	32,115	4,523
2220.00	Operator Systems	.844	10,599	8,945	795	671	668	564	-107
2231.00	Radio Systems	.660	27,924	18,430	2,457	1,622	1,620	1,069	-553
2232.00	Circuit-Other	.660	703,833	464,530	69,679	45,988	68,272	45,059	-929
2232.11	Circuit-DDS	.660	11,238	7,417	1,225	808	1,371	905	96
2311.00	Station Apparatus	.751	324	244	63	47	36	27	-20
2341.00	Large PBX	.751	5,913	4,440	1,200	901	1,047	786	-115
2351.00	Public Telephone	.751	26,216	19,688	2,176	1,634	1,756	1,319	-315
2362.00	Other Terminal Equip.	.751	30,488	22,897	3,537	2,656	3,079	2,313	-343
2411.00	Poles	.739	104,339	77,106	4,695	3,470	4,904	3,624	154
2421.10	Aerial Cable Metal	.739	463,721	342,690	28,287	20,904	30,142	22,275	1,371
2421.20	Aerial Cable Fiber	.739	27,805	20,548	1,474	1,089	1,529	1,130	41
2422.10	Undergrd Cable Metal	.739	217,201	160,512	9,557	7,063	9,991	7,384	321
2422.20	Undergrd Cable Fiber	.739	34,120	25,215	1,808	1,336	1,808	1,336	0
2423.10	Buried Cable Metal	.739	642,869	475,080	32,786	24,229	35,358	26,129	1,900
2423.20	Buried Cable Fiber	.739	17,773	13,134	1,031	762	1,013	749	-13
2424.00	Submarine Cable	.739	1,215	898	45	33	55	40	7
2426.00	Intra-Bldg Netwk Cable	.739	18,592	13,740	1,171	866	1,078	797	-69
2431.00	Aerial Wire	.739	20,141	14,884	967	714	926	685	-30
2441.00	Conduit System	.739	155,132	114,642	2,637	1,949	2,792	2,064	115
	TOTAL		3,749,963	2,803,752	252,324	187,676	271,173	202,661	14,986
	Composite Rate (%)				6.7	6.7	7.2	7.2	