

# TENNESSEE REGULATORY AUTHORITY

Tre Hargett, Chairman  
Eddie Roberson, Director  
Sara Kyle, Director  
Mary Freeman, Director



460 James Robertson Parkway  
Nashville, Tennessee 37243-0505

January 13, 2009

The Honorable Susan Lynn  
State Representative  
57<sup>th</sup> District  
215 War Memorial Building  
Nashville, Tennessee 37243-0157

Re: Contested Case Rate Hearings before the Tennessee Regulatory Authority

Dear Representative Lynn:

Due to your interest in the current contested case proceeding before the Tennessee Regulatory Authority ("TRA") involving a proposed rate increase request by Tennessee Wastewater Systems, Inc. (TRA Docket No. 08 – 00202), I believe it would be helpful to provide certain information regarding the conduct of rate case proceedings in front of the TRA. It is important to note at the outset that by statute a rate making proceeding is a contested case.

The term "contested case" is defined in two statutes which govern the practices and procedures of the TRA. In both instances, the definition of a contested case includes a ratemaking proceeding. Tenn. Code Ann. § 4-5-102(3), a section in the Tennessee Uniform Administrative Procedures Act, provides the following definition:

(3) "Contested case" means a proceeding, including a declaratory proceeding, in which the legal rights, duties or privileges of a party are required by any statute or constitutional provision to be determined by an agency after an opportunity for a hearing. Such proceeding may include *rate making*; price fixing; granting of certificates of convenience and necessity; the making, review or equalization of tax assessments; the granting or denial of licenses, permits or franchises where the licensing board is not required to grant the licenses, permits or franchises upon the payment of a fee or the finding of certain clearly defined criteria; and suspensions of, revocations of, and refusals to renew licenses. An agency may commence a contested case at any time with respect to a matter within the agency's jurisdiction; (Emphasis provided.)

Title 65, which specifically addresses public utility regulation, contains a definition of contested case in Tenn. Code Ann. § 65-2-101(2) as follows:

(2) "Contested case" means all proceedings before the authority in which the legal rights, duties, or privileges of specific parties are determined after a hearing

before the authority; *provided, that the fixing of rates shall be deemed a contested case rather than a rule-making proceeding*; (Emphasis provided.)

Through the convening of a contested case, certain rules of procedure become applicable to the proceeding. In such a matter, the procedural dictates and due process guarantees of statutes and rules immediately affix to the case. Contested case proceedings at the TRA are governed by the Uniform Administrative Procedures Act ("UAPA"), found at Tenn. Code Ann. § 4-5-101 *et. seq.*

Under the UAPA, a "party" to a contested case proceeding is defined as "each person or agency named or admitted as a party, or properly seeking and entitled as of right to be admitted as a party;" (Tenn. Code Ann. § 4-5-102(8)). Tenn. Code Ann. § 4-5-310(a) sets forth the following criteria for granting petitions to intervene:

- (a) The administrative judge or hearing officer shall grant one (1) or more petitions for intervention if;
  - (1) The petition is submitted in writing to the administrative judge or hearing officer, with copies mailed to all parties named in the notice of the hearing, at least seven (7) days before the hearing;
  - (2) The petition states facts demonstrating that the petitioner's legal rights, duties, privileges, immunities or other legal interest may be determined in the proceeding or that the petitioner qualifies as an intervenor under any provision of the law; and
  - (3) The administrative judge or hearing officer determines that the interests of justice and the orderly and prompt conduct of the proceedings shall not be impaired by allowing the intervention.

Under Tenn. Code Ann. § 65-2-107:

All persons having a right under the provisions of the laws applicable to the authority to appear and be heard in contested cases as defined in this chapter shall be deemed parties to such proceedings for the purposes of this chapter. In addition, the authority may upon motion allow any interested person to intervene and become a party to any contested case.

TRA Rule 1220-1-2-.08 provides that petition for interventions filed with the TRA "... shall be granted in accordance with [Tenn. Code Ann.] § 4-5-310 and [Tenn. Code Ann.] § 65-2-107" and "... shall be filed at least seven (7) days prior to the date of the contested case hearing." Under TRA Rule 1220-1-2-.06, any party opposing a motion in a contested case, including a

request for intervention, must file and serve a response to the motion within seven days of service of the motion.

Initially, all filings at the TRA that require a contested case hearing receive a docket number and are assigned to a panel of three Directors. Under the UAPA and Title 65, contested cases at the TRA can be presided over by a Hearing Officer or the panel of Directors. In most rate cases, because of the complexity of the issues, a Hearing Officer is appointed to handle preliminary matters and to prepare the matter for hearing by the panel. Such preliminary matters include: ruling on petitions for intervention, determining issues lists, entering protective orders, establishing a procedural schedule, resolving discovery disputes between the parties, ruling on various pre-hearing motions, etc.

Upon the convening of a contested case proceeding, Part 3 of the UAPA takes effect and certain restrictions are placed on the roles of the Directors and members of the TRA in the conduct of the proceeding. Tenn. Code Ann. § 4-5-303 requires that the prosecutorial and the adjudicative functions of the TRA be separated. A person who has acted in an investigative or prosecutorial role in a contested case cannot serve as, or act as an advisor to, a hearing officer or administrative judge in the same proceeding. Moreover, the Directors and staff of the TRA must strictly follow the requirements pertaining to *ex parte* communications, set forth in pertinent part at Tenn. Code Ann. § 4-5-304 as follows:

**4-5-304. Ex parte communications.-** (a) Unless required for the disposition of ex parte matters specifically authorized by statute, an administrative judge, hearing officer or agency member serving in a contested case proceeding may not communicate, directly or indirectly, regarding any issue in the proceeding, while the proceeding is pending, with any person without notice and opportunity for all parties to participate in the communication.

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(c) Unless required for the disposition of ex parte matters specifically authorized by statute, no party to a contested case, and no other person may communicate, directly or indirectly, in connection with any issue in that proceeding, while the proceeding is pending, with any person serving as an administrative judge, hearing officer or agency member without notice and opportunity for all parties to participate in the communication.

(d) If, before serving as an administrative judge, hearing officer or agency member in a contested case, a person receives an ex parte communication of a type that may not properly be received while serving, the person, promptly after starting to serve, shall disclose the communication in the manner prescribed in subsection (e).

(e) An administrative judge, hearing officer or agency member who receives an ex parte communication in violation of this section shall place on the record of the pending matter all written communications received, all written responses to the communications, and a memorandum stating the substance of all oral communications received, all responses made, and the identity of each person from whom the person received an ex parte communication, and shall advise all parties that these matters have been placed on the record. Any party desiring to rebut the ex parte communication shall be allowed to do so, upon requesting the opportunity for rebuttal within ten (10) days after notice of the communication.

(f) An administrative judge, hearing officer or agency member who receives an ex parte communication in violation of this section may be disqualified if necessary to eliminate the effect of the communication.

A violation of Tenn. Code Ann. § 4-5-303 or Tenn. Code Ann. § 4-5-304 can subject a Director or Hearing Officer to disqualification from participation in the contested case, pursuant to Tenn. Code Ann. § 4-5-302.

The UAPA, together with the procedural rules of the TRA, set forth procedural guidelines for the prehearing, hearing and post-hearing phases of a contested case proceeding. These rules assist parties in the presentation of their respective cases and establish procedural parameters for the TRA in hearing and deliberating the contested case. Through the UAPA, parties are afforded review rights of the agency's decisions through reconsideration and review of initial orders, and reconsideration and appeal of final orders. Unlike other state agencies whose orders are reviewable in Chancery Court, the decisions of the TRA are appealable directly to the Middle Section of the Tennessee Court of Appeals. Tenn. Code Ann. § 4-5-322 establishes the statutory bases and procedures for appellate review of TRA decisions.

Tenn. Code Ann. § 65-5-101 grants the TRA the power to fix rates of public utilities. Pursuant to Tenn. Code Ann. § 65-5-103(a), the TRA has the authority to make a determination, after a hearing, whether an increase to an existing rate or an alteration in an existing classification proposed by a public utility is "just and reasonable."<sup>1</sup> The Authority is obligated to balance the interests of the utilities subject to its jurisdiction with the interests of Tennessee consumers, i.e., it is obligated to fix just and reasonable rates.<sup>2</sup> The Authority must also approve rates that provide regulated utilities the opportunity to earn a just and reasonable return on their investments.<sup>3</sup>

Tenn. Code Ann. § 65-5-103 sets forth the procedure which must be followed when a public utility seeks a rate increase. Tenn. Code Ann. § 65-5-103 provides:

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<sup>1</sup> Tenn. Code Ann. § 65-5-203(a).

<sup>2</sup> Tenn. Code Ann. § 65-5-201 (Supp. 2002).

<sup>3</sup> See *Bluefield Water Works and Improvement Company v. Public Service Commission of the State of West Virginia*, 262 U.S. 679, 43 S.Ct. 675 (1923).

(a) When any public utility shall increase any existing individual rates, joint rates, tolls, fares, charges, or schedules thereof, or change or alter any existing classification, the authority shall have power either upon written complaint, or upon its own initiative, to hear and determine whether the increase, change or alteration is just and reasonable. The burden of proof to show that the increase, change, or alteration is just and reasonable shall be upon the public utility making the same. In determining whether such increase, change or alteration is just and reasonable, the authority shall take into account the safety, adequacy and efficiency or lack thereof of the service or services furnished by the public utility. The authority shall have authority pending such hearing and determination to order the suspension, not exceeding three (3) months from the date of the increase, change, or alteration until the authority shall have approved the increase, change, or alteration; provided, that if the investigation cannot be completed within three (3) months, the authority shall have authority to extend the period of suspension for such further period as will reasonably enable it to complete its investigation of any such increase, change or alteration; and provided further, that the authority shall give the investigation preference over other matters pending before it and shall decide the matter as speedily as possible, and in any event not later than nine (9) months after the filing of the increase, change or alteration. It shall be the duty of the authority to approve any such increase, change or alteration upon being satisfied after full hearing that the same is just and reasonable.

(b)(1) If the investigation has not been concluded and a final order made at the expiration of six (6) months from the date filed of any such increase, change or alteration, the utility may place the proposed increase, change or alteration, or any portion thereof, in effect at any time thereafter prior to the final authority decision thereon upon notifying the authority, in writing, of its intention so to do; provided, that the authority may require the utility to file with the authority a bond in an amount equal to the proposed annual increase conditioned upon making any refund ordered by the authority as provided in subdivision (b)(2).

(2) Where increased rates or charges are thus made effective, the interested utility shall maintain its records in such a manner as will enable it, or the authority, to determine the amounts to be refunded and to whom due, in the event a refund is subsequently ordered by the authority as provided in this subdivision (b)(2). Upon completion of the hearing and decision, the authority may order the utility to refund, to the persons in whose behalf such amounts were paid, such portion of such increase, change or alteration as shall have been collected under bond and subsequently disallowed by the authority. If the authority, at any time during the initial three (3) months' suspension period, finds that an emergency exists or that the utility's credit or operations will be materially impaired or damaged by the failure to permit the rates to become effective during the three-month period, the

authority may permit all or a portion of the increase, change or alteration to become effective under such terms and conditions as the authority may by order prescribe. Any increase, change or alteration placed in effect under the provisions of this subsection (b) under bond may be continued in effect by the utility, pending final determination of the proceeding by final order of the authority or, if the matter be appealed, by final order of the appellate court. Should the final order of the authority be appealed while increased rates or charges are being collected under bond, the court shall have power to order an increase or decrease in the amount of the bond as the court may determine to be proper. In the event that all or any portion of such rates or charges have not been placed into effect under bond before the authority, the court considering an appeal from an order of the authority shall have the power to permit the utility to place all or any part of the rates or charges into effect under bond.

(c) In the event the authority, by order, directs any utility to make a refund, as provided in subsection (b), of all or any portion of such increase, change or alteration, the utility shall make the same within ninety (90) days after a final determination of the proceeding by final order of the authority or, if the matter be appealed, by final order of the appellate court, with lawful interest thereon.

Typically, the effectiveness of rate increase requests are suspended for certain periods of time to provide ample opportunity for the parties to engage in discovery and file pre-filed testimony of witnesses. In most instances the hearing in a rate case will be held within six months of the filing of the petition. Tenn. Code Ann. §65-2-108 provides:

All parties to contested cases shall be afforded an opportunity for hearing after reasonable notice. The notice shall state the time, place, and issues involved as specifically as may be practicable. At the hearing all parties shall be afforded an opportunity to present evidence and argument in accordance with the rules of the authority; provided, that informal disposition may also be made of any case by stipulation, agreed settlement, consent order, or default; and provided further, that this section shall not be applicable to proceedings otherwise provided for by law

In limited situations, TRA Staff may participate in a contested case as a party and in such instances will engage in discovery and submit pre-filed testimony. Nevertheless, in most rate cases filed with the TRA, the Consumer Advocate and Protection Division of the Office of the Attorney General ("Consumer Advocate") will intervene as a party. The creation of the Consumer Advocate and the powers attendant to that division are found in Tenn. Code Ann. § 65-4-118. Subsection (b) of that section sets forth the extent of the powers as to the Consumer Advocate's role in appearing before the TRA. Section 65-4-118(b) states:

(b)(1) The consumer advocate division *has the duty and authority to represent the interests of Tennessee consumers* of public utilities services. The division may, with the approval of the attorney general and reporter, participate or intervene as a party in any matter or proceeding before the authority or any other administrative, legislative or judicial body and initiate such proceeding, in accordance with the Uniform Administrative Procedures Act, compiled in title 4, chapter 5, and the rules of the authority. (Emphasis provided)

Tenn. Code Ann. § 65-2-109 states that the burden of proof in a contested case proceeding “. . . shall be on the party or parties asserting the affirmative of an issues and that, for evidence to be considered by the TRA, such evidence must be made a part of the record of the proceeding. In contested cases, the TRA may apply but is not bound to the Rules of Evidence as may be applicable in a court of law. The TRA “. . . may admit and give probative effect to any evidence which possess such probative value as would entitle it to be accepted by reasonably prudent persons in the conduct of their affairs. . .” Tenn. Code Ann. § 65-2-109(1).

There is no specific formula for establishing rates for a public utility. The Authority considers petitions for a rate increase, filed pursuant to Tenn. Code Ann. § 65-5-103, in light of the following criteria, while also balancing the needs of consumers for continued quality service.

1. The investment or rate base upon which the utility should be permitted to earn a fair rate of return;
2. The proper level of revenues for the utility;
3. The proper level of expenses for the utility; and
4. The rate of return the utility should earn.

The general standards to be considered in establishing the costs of common equity for a public utility are financial integrity, capital attraction and setting a return on equity that is commensurate with returns investors could achieve by investing in other enterprises of corresponding risk. The utility's cost of common equity is the minimum return investors expect, or require, in order to make an investment in the utility. The proper level of return on the Company's capital, including equity capital, must allow a return on capital that is commensurate with returns on investment in other enterprises having corresponding risk.<sup>4</sup>

In determining a fair rate of return, the Authority must conduct an in-depth analysis and give proper consideration to numerous factors, such as capital structure, cost of capital and changes which can reasonably be anticipated in the foreseeable future. The Authority has the obligation to make this determination based upon the controlling legal standard set forth in the landmark cases of *Bluefield Water Works and Improvement Company v. Public Service*

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<sup>4</sup> See *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 64 S.Ct. 281 (1944).

*Commission of the State of West Virginia*<sup>5</sup> and *Federal Power Commission v. Hope Natural Gas Company*,<sup>6</sup> which have been specifically relied upon by the Tennessee Supreme Court.<sup>7</sup> In the *Bluefield* case, the United States Supreme 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 risk and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises 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.<sup>8</sup>

Later, in the *Hope* case, the United States Supreme Court refined these guidelines, holding that:

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.<sup>9</sup>

Applying these principles, and upon consideration of the entire record, including all exhibits and the testimony of the witnesses, the Authority makes findings and conclusions. As noted by the Tennessee Supreme Court, there is little guidance in the case law regarding the methods to be followed in rate making in that courts have stated that they will play a limited role in reviewing actions which they consider essentially legislative in character. Because rate making is not a judicial function, great deference has been granted by the courts in reviewing the TRA's decisions. *CF Industries v. Public Service Commission*, 599 S.W.2d 536, 542 (Tenn. 1980). The Courts give consideration to the agency's "experience, technical competence, and specialized knowledge." *Id.* at 540. The only limit Courts have placed on the TRA is that the rates must be "just and reasonable." *Tenn. Cable Television Ass'n v. Tenn. Pub. Serv. Comm'n*, 844 S.W.2d 151 (Tenn. Ct. App. 1992). As a result, the TRA is not required to determine rates using definite rules, a particular process, or precise formulas. A rate need only fall within the

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<sup>5</sup> *Bluefield Water Works and Improvement Company v. Public Service Commission of the State of West Virginia*, 262 U.S. 679, 43 S.Ct. 675 (1923).

<sup>6</sup> *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 64 S.Ct. 281 (1944).

<sup>7</sup> *Southern Bell Telephone & Telegraph Co. v. Public Service Commission*, 304 S.W.2d 640, 647 (1957).

<sup>8</sup> *Bluefield*, 262 U.S. at 692-93.

<sup>9</sup> *Hope*, 320 U.S. at 603.



“zone of reasonableness” that takes into consideration the interests of both the consumer and the utility. Rate-making requires the TRA to balance and weigh many factors.

Public utilities petitioning for rate increases have the burden to demonstrate that such increases are warranted. Upon filing, a petition for a rate increase is generally accompanied by expert testimony, exhibits and any other information (invoices of expenses, general ledger, tax returns, salary and benefit plans, etc.) that the utility deems necessary to justify its proposed rate increase. Subsequent to initial review of a rate petition filed with the Authority, discovery requests are sent by both the Consumer Advocate and any other parties to the case to gather additional information necessary to determine the utility’s reasonable cost plus a return to investors, for provisioning quality service to its customers. In the preparation for and the deliberation of the issues in a rate case, the Directors of the TRA rely upon the advice of TRA Staff. In a contested case rate proceeding, TRA Advisory Staff may issue data requests to the public utility in an effort to obtain documents and information that will support or refute the rate increase request.

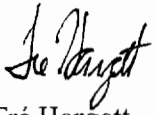
As a part of its case, the Consumer Advocate provides expert testimony and exhibits demonstrating what it contends is a reasonable level of earnings that the utility should be allowed to return, along with a proposed rates designed to recover the required amount of revenues. The utility is then given the opportunity to provide additional testimony to rebut the Consumer Advocate’s positions. A publicly noticed evidentiary hearing, open to the public, is conducted to formally present the parties’ cases before the TRA Directors. Pursuant to Tenn. Code Ann. § 65-2-109(3), “Every party shall have the right of cross-examination of witnesses who testify, and shall have the right to submit rebuttal evidence.” During the hearing, TRA Directors and Authority Staff have the opportunity to ask questions of all witnesses. Also during the hearing, there is provided an opportunity for consumers and members of the public to provide comments on the record and to the presiding panel regarding the quality of service provided and the amount of the rate increase being requested by the public utility. Post-hearing briefs summarizing the evidence presented at the hearing and setting forth the parties’ respective legal positions are often filed by parties.

TRA Advisory Staff, relying upon many years of accounting, engineering, economic and overall ratemaking experience, analyze the positions and evidence set forth by each party. Staff develops its positions on all issues and serves as advisor to the TRA Directors. The panel of Directors assigned to the specific rate case, in an open meeting, makes findings and renders its decisions regarding the reasonable level of earnings that the utility should be allowed, including specific rates designed to recover the granted amount of revenues. Thereafter, an Order is issued by the TRA memorializing the decision of the panel. The UAPA and the TRA rules provide the parties the opportunity to request reconsideration from the panel regarding any issue related to the decision. After an issue is reconsidered by the TRA or when the allotted amount of time for filing a reconsideration request has passed, parties have the opportunity to appeal the Authority’s decision to the Tennessee Court of Appeals.

Representative Susan Lynn  
January 13, 2009  
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I hope the foregoing is helpful in explaining the role of the TRA in conducting a contested case rate proceeding. As indicated, the hearing in a rate case is an open hearing in which public comment is welcomed and encouraged. At the present time Docket No 08-00202 has not been set for hearing before the panel. Nevertheless, when the matter is set, notice will be provided to the public. If you would like to provide public testimony, I encourage you to do so during the hearing.

Very truly yours,

A handwritten signature in black ink, appearing to read "Tré Hargett", written in a cursive style.

Tré Hargett  
Chairman

cc: Senator Mae Beavers  
Docket No. 08-00202

# TENNESSEE REGULATORY AUTHORITY



Tre Hargett, Chairman  
Eddie Roberson, Director  
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Mary Freeman, Director

460 James Robertson Parkway  
Nashville, Tennessee 37243-0505

January 13, 2009

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State Senator  
17<sup>th</sup> District  
308 War Memorial Building  
Nashville, Tennessee 37243-0217

Re: Contested Case Rate Hearings before the Tennessee Regulatory Authority

Dear Senator Beavers:

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<sup>2</sup> Tenn. Code Ann. § 65-5-201 (Supp. 2002).

<sup>3</sup> See *Bluefield Water Works and Improvement Company v. Public Service Commission of the State of West Virginia*, 262 U.S. 679, 43 S.Ct. 675 (1923).

(a) When any public utility shall increase any existing individual rates, joint rates, tolls, fares, charges, or schedules thereof, or change or alter any existing classification, the authority shall have power either upon written complaint, or upon its own initiative, to hear and determine whether the increase, change or alteration is just and reasonable. The burden of proof to show that the increase, change, or alteration is just and reasonable shall be upon the public utility making the same. In determining whether such increase, change or alteration is just and reasonable, the authority shall take into account the safety, adequacy and efficiency or lack thereof of the service or services furnished by the public utility. The authority shall have authority pending such hearing and determination to order the suspension, not exceeding three (3) months from the date of the increase, change, or alteration until the authority shall have approved the increase, change, or alteration; provided, that if the investigation cannot be completed within three (3) months, the authority shall have authority to extend the period of suspension for such further period as will reasonably enable it to complete its investigation of any such increase, change or alteration; and provided further, that the authority shall give the investigation preference over other matters pending before it and shall decide the matter as speedily as possible, and in any event not later than nine (9) months after the filing of the increase, change or alteration. It shall be the duty of the authority to approve any such increase, change or alteration upon being satisfied after full hearing that the same is just and reasonable.

(b)(1) If the investigation has not been concluded and a final order made at the expiration of six (6) months from the date filed of any such increase, change or alteration, the utility may place the proposed increase, change or alteration, or any portion thereof, in effect at any time thereafter prior to the final authority decision thereon upon notifying the authority, in writing, of its intention so to do; provided, that the authority may require the utility to file with the authority a bond in an amount equal to the proposed annual increase conditioned upon making any refund ordered by the authority as provided in subdivision (b)(2).

(2) Where increased rates or charges are thus made effective, the interested utility shall maintain its records in such a manner as will enable it, or the authority, to determine the amounts to be refunded and to whom due, in the event a refund is subsequently ordered by the authority as provided in this subdivision (b)(2). Upon completion of the hearing and decision, the authority may order the utility to refund, to the persons in whose behalf such amounts were paid, such portion of such increase, change or alteration as shall have been collected under bond and subsequently disallowed by the authority. If the authority, at any time during the initial three (3) months' suspension period, finds that an emergency exists or that the utility's credit or operations will be materially impaired or damaged by the failure to permit the rates to become effective during the three-month period, the

authority may permit all or a portion of the increase, change or alteration to become effective under such terms and conditions as the authority may by order prescribe. Any increase, change or alteration placed in effect under the provisions of this subsection (b) under bond may be continued in effect by the utility, pending final determination of the proceeding by final order of the authority or, if the matter be appealed, by final order of the appellate court. Should the final order of the authority be appealed while increased rates or charges are being collected under bond, the court shall have power to order an increase or decrease in the amount of the bond as the court may determine to be proper. In the event that all or any portion of such rates or charges have not been placed into effect under bond before the authority, the court considering an appeal from an order of the authority shall have the power to permit the utility to place all or any part of the rates or charges into effect under bond.

(c) In the event the authority, by order, directs any utility to make a refund, as provided in subsection (b), of all or any portion of such increase, change or alteration, the utility shall make the same within ninety (90) days after a final determination of the proceeding by final order of the authority or, if the matter be appealed, by final order of the appellate court, with lawful interest thereon.

Typically, the effectiveness of rate increase requests are suspended for certain periods of time to provide ample opportunity for the parties to engage in discovery and file pre-filed testimony of witnesses. In most instances the hearing in a rate case will be held within six months of the filing of the petition. Tenn. Code Ann. §65-2-108 provides:

All parties to contested cases shall be afforded an opportunity for hearing after reasonable notice. The notice shall state the time, place, and issues involved as specifically as may be practicable. At the hearing all parties shall be afforded an opportunity to present evidence and argument in accordance with the rules of the authority; provided, that informal disposition may also be made of any case by stipulation, agreed settlement, consent order, or default; and provided further, that this section shall not be applicable to proceedings otherwise provided for by law

In limited situations, TRA Staff may participate in a contested case as a party and in such instances will engage in discovery and submit pre-filed testimony. Nevertheless, in most rate cases filed with the TRA, the Consumer Advocate and Protection Division of the Office of the Attorney General ("Consumer Advocate") will intervene as a party. The creation of the Consumer Advocate and the powers attendant to that division are found in Tenn. Code Ann. § 65-4-118. Subsection (b) of that section sets forth the extent of the powers as to the Consumer Advocate's role in appearing before the TRA. Section 65-4-118(b) states:



(b)(1) The consumer advocate division *has the duty and authority to represent the interests of Tennessee consumers* of public utilities services. The division may, with the approval of the attorney general and reporter, participate or intervene as a party in any matter or proceeding before the authority or any other administrative, legislative or judicial body and initiate such proceeding, in accordance with the Uniform Administrative Procedures Act, compiled in title 4, chapter 5, and the rules of the authority. (Emphasis provided)

Tenn. Code Ann. § 65-2-109 states that the burden of proof in a contested case proceeding “. . . shall be on the party or parties asserting the affirmative of an issues and that, for evidence to be considered by the TRA, such evidence must be made a part of the record of the proceeding. In contested cases, the TRA may apply but is not bound to the Rules of Evidence as may be applicable in a court of law. The TRA “. . . may admit and give probative effect to any evidence which possess such probative value as would entitle it to be accepted by reasonably prudent persons in the conduct of their affairs. . .” Tenn. Code Ann. § 65-2-109(1).

There is no specific formula for establishing rates for a public utility. The Authority considers petitions for a rate increase, filed pursuant to Tenn. Code Ann. § 65-5-103, in light of the following criteria, while also balancing the needs of consumers for continued quality service.

1. The investment or rate base upon which the utility should be permitted to earn a fair rate of return;
2. The proper level of revenues for the utility;
3. The proper level of expenses for the utility; and
4. The rate of return the utility should earn.

The general standards to be considered in establishing the costs of common equity for a public utility are financial integrity, capital attraction and setting a return on equity that is commensurate with returns investors could achieve by investing in other enterprises of corresponding risk. The utility's cost of common equity is the minimum return investors expect, or require, in order to make an investment in the utility. The proper level of return on the Company's capital, including equity capital, must allow a return on capital that is commensurate with returns on investment in other enterprises having corresponding risk.<sup>4</sup>

In determining a fair rate of return, the Authority must conduct an in-depth analysis and give proper consideration to numerous factors, such as capital structure, cost of capital and changes which can reasonably be anticipated in the foreseeable future. The Authority has the obligation to make this determination based upon the controlling legal standard set forth in the landmark cases of *Bluefield Water Works and Improvement Company v. Public Service*

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<sup>4</sup> See *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 64 S.Ct. 281 (1944).

*Commission of the State of West Virginia*<sup>5</sup> and *Federal Power Commission v. Hope Natural Gas Company*,<sup>6</sup> which have been specifically relied upon by the Tennessee Supreme Court.<sup>7</sup> In the *Bluefield* case, the United States Supreme 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 risk and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises 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.<sup>8</sup>

Later, in the *Hope* case, the United States Supreme Court refined these guidelines, holding that:

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.<sup>9</sup>

Applying these principles, and upon consideration of the entire record, including all exhibits and the testimony of the witnesses, the Authority makes findings and conclusions. As noted by the Tennessee Supreme Court, there is little guidance in the case law regarding the methods to be followed in rate making in that courts have stated that they will play a limited role in reviewing actions which they consider essentially legislative in character. Because rate making is not a judicial function, great deference has been granted by the courts in reviewing the TRA's decisions. *CF Industries v. Public Service Commission*, 599 S.W.2d 536, 542 (Tenn. 1980). The Courts give consideration to the agency's "experience, technical competence, and specialized knowledge." *Id.* at 540. The only limit Courts have placed on the TRA is that the rates must be "just and reasonable." *Tenn. Cable Television Ass'n v. Tenn. Pub. Serv. Comm'n*, 844 S.W.2d 151 (Tenn. Ct. App. 1992). As a result, the TRA is not required to determine rates using definite rules, a particular process, or precise formulas. A rate need only fall within the

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<sup>5</sup> *Bluefield Water Works and Improvement Company v. Public Service Commission of the State of West Virginia*, 262 U.S. 679, 43 S.Ct. 675 (1923).

<sup>6</sup> *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 64 S.Ct. 281 (1944).

<sup>7</sup> *Southern Bell Telephone & Telegraph Co. v. Public Service Commission*, 304 S.W.2d 640, 647 (1957).

<sup>8</sup> *Bluefield*, 262 U.S. at 692-93.

<sup>9</sup> *Hope*, 320 U.S. at 603.

“zone of reasonableness” that takes into consideration the interests of both the consumer and the utility. Rate-making requires the TRA to balance and weigh many factors.

Public utilities petitioning for rate increases have the burden to demonstrate that such increases are warranted. Upon filing, a petition for a rate increase is generally accompanied by expert testimony, exhibits and any other information (invoices of expenses, general ledger, tax returns, salary and benefit plans, etc.) that the utility deems necessary to justify its proposed rate increase. Subsequent to initial review of a rate petition filed with the Authority, discovery requests are sent by both the Consumer Advocate and any other parties to the case to gather additional information necessary to determine the utility’s reasonable cost plus a return to investors, for provisioning quality service to its customers. In the preparation for and the deliberation of the issues in a rate case, the Directors of the TRA rely upon the advice of TRA Staff. In a contested case rate proceeding, TRA Advisory Staff may issue data requests to the public utility in an effort to obtain documents and information that will support or refute the rate increase request.

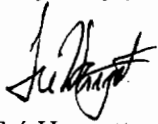
As a part of its case, the Consumer Advocate provides expert testimony and exhibits demonstrating what it contends is a reasonable level of earnings that the utility should be allowed to return, along with a proposed rates designed to recover the required amount of revenues. The utility is then given the opportunity to provide additional testimony to rebut the Consumer Advocate’s positions. A publicly noticed evidentiary hearing, open to the public, is conducted to formally present the parties’ cases before the TRA Directors. Pursuant to Tenn. Code Ann. § 65-2-109(3), “Every party shall have the right of cross-examination of witnesses who testify, and shall have the right to submit rebuttal evidence.” During the hearing, TRA Directors and Authority Staff have the opportunity to ask questions of all witnesses. Also during the hearing, there is provided an opportunity for consumers and members of the public to provide comments on the record and to the presiding panel regarding the quality of service provided and the amount of the rate increase being requested by the public utility. Post-hearing briefs summarizing the evidence presented at the hearing and setting forth the parties’ respective legal positions are often filed by parties.

TRA Advisory Staff, relying upon many years of accounting, engineering, economic and overall ratemaking experience, analyze the positions and evidence set forth by each party. Staff develops its positions on all issues and serves as advisor to the TRA Directors. The panel of Directors assigned to the specific rate case, in an open meeting, makes findings and renders its decisions regarding the reasonable level of earnings that the utility should be allowed, including specific rates designed to recover the granted amount of revenues. Thereafter, an Order is issued by the TRA memorializing the decision of the panel. The UAPA and the TRA rules provide the parties the opportunity to request reconsideration from the panel regarding any issue related to the decision. After an issue is reconsidered by the TRA or when the allotted amount of time for filing a reconsideration request has passed, parties have the opportunity to appeal the Authority’s decision to the Tennessee Court of Appeals.

Senator Mae Beavers  
January 13, 2009  
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I hope the foregoing is helpful in explaining the role of the TRA in conducting a contested case rate proceeding. As indicated, the hearing in a rate case is an open hearing in which public comment is welcomed and encouraged. At the present time Docket No 08-00202 has not been set for hearing before the panel. Nevertheless, when the matter is set, notice will be provided to the public. If you would like to provide public testimony, I encourage you to do so during the hearing.

Very truly yours,

A handwritten signature in black ink, appearing to read "Tré Hargett", written in a cursive style.

Tré Hargett  
Chairman

cc: Representative Susan Lynn  
Docket No. 08-00202