BEFORE THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE

IN RE:	)	
	)	
INVESTIGATION AS TO WHETHER A SHOW CAUSE ORDER SHOULD BE ISSUED AGAINST BERRY'S CHAPEL UTILITY, INC., AND/OR LYNWOOD UTILITY CORPORATION FOR VIOLATION OF TRA RULE AND TENNESSEE STATUTES, INCLUDING BUT NOT LIMITED TO, TENN. CODE ANN. §§ 65-4-112, 65-4-113, 65-4-201, AND 65-5-101	)	**DOCKET NO. 11-00065**

INITIAL BRIEF OF BERRY'S CHAPEL

Berry's Chapel Utility, Inc. ("Berry's Chapel") submits this brief in support of the Settlement Agreement filed May 31, 2013 and in reply to the Initial Brief filed by the Consumer Advocate. An evidentiary hearing in this matter is scheduled for September 9, 2013.

Summary and Statement of Facts

This is a "show cause" proceeding opened by the Authority pursuant to T.C.A. § 65-3-106 to investigate Berry's Chapel for possible violations of state law and the agency's rules. As required by the Uniform Administrative Procedures Act, the agency designated members of the Staff to undertake this investigation and to participate as a party in this proceeding.[1] After several months of negotiations, the Staff and Berry's Chapel reached a comprehensive settlement of all issues and recommend that Settlement to the Authority. The details are spelled out in the

[1] References in this brief to the "Staff" refer to the TRA employees (Shiva Bozarth, Jerry Kettles and Tiffany Underwood) who have been assigned to investigate and, if necessary, prosecute this enforcement proceeding against Berry's Chapel. These employees have been administratively separated from the TRA's advisory staff as required by T.C.A. § 4-5-303(a) and § 4-5-304.

Agreement itself and in the pre-filed testimony of Staff witness Tiffany Underwood and Berry's Chapel witness Terry Buckner.

In sum, Berry's Chapel and the Staff collaboratively identified a total of approximately $146,000 in wastewater charges collected from customers without the approval of the Authority. All but about $12,000 of that was collected by Berry's Chapel during the time when Berry's Chapel, acting in good faith and upon the advice of counsel, believed that the utility was not subject to the jurisdiction of the Authority. The remaining $12,000 was collected as the result of a billing error by the City of Franklin, and Berry's Chapel was not aware of the error until it was discovered during the utility's last rate case.

As explained in the Settlement, the Staff and Company agree that the entire $146,000 in unauthorized rates must either be spent to benefit customers or refunded to them. Approximately half of the total is already being refunded to those individual customers who can be identified from the Company's billing records as having paid unauthorized charges. Of the remaining amount, which cannot be reliably traced to current customers, the Staff and the Company agree that approximately $60,000 has been spent by the utility to control odor problems[2] and recover damages from the 2010 flood[3] and that Berry's Chapel is entitled to be reimbursed by the utility's

[2] See Docket 08-00060 for a history of the odor control issue. The Company started collecting an odor control surcharge in 2009 pursuant to a negotiated settlement with the Consumer Advocate which was approved by the Authority. When the surcharge was scheduled to expire in 2010, the Company reorganized as a non-profit and believed that it was no longer subject to the TRA's jurisdiction. After the Authority ruled that Berry's Chapel was still under the Authority's control, the Company filed a report with the Authority on November 4, 2011, accounting for all collections and expenses related to odor control and explaining that, since the Company had not yet recovered all of its odor control expenses, the Company was continuing to collect the surcharge. The surcharge remained in place, with the knowledge of the Authority and the Consumer Advocate, until the Company was granted a general rate increase in June, 2012, in Docket 11-00198.

[3] See Docket 11-00180 for a history of the Company's efforts to recover damages arising from the 2010 flood. The Company petitioned to recover $180,000 in flood damages and, following a hearing, was awarded approximately half of that amount. The legal expenses incurred in making those claims totaled about $20,000. The Settlement Agreement allows the Company is to recover most of these expenses. These expenses continue to increase, however, as the Company incurs additional legal fees in negotiating and defending the Settlement Agreement.

customers for those expenses. The Company will pay an additional $12,000 into an escrow account held for the customers' future benefit. Finally, the Company has agreed to pay $8,000—over and above the $146,000 that was improperly collected—as a penalty for its actions[4]. This amount will be added to the escrow account. The Staff and the Company agree that the escrow account, which will be maintained under the Authority's control, will satisfy the TRA's financial security requirements for wastewater utilities.[5]

Although the Consumer Advocate participated in many settlement negotiations with the Staff and Berry's Chapel, the Advocate does not join in the final Agreement and argues that the Authority should reject it. The policy arguments all boil down to one—and only one—issue: is the Settlement Agreement reasonable and in the public interest? The Company and Staff will present evidence and argument at the hearing to demonstrate that the Agreement is fair and should be approved. The Consumer Advocate's legal objections to the Settlement are discussed below.

I. Does the TRA Staff have the right to negotiate a settlement with Berry's Chapel and recommend the Settlement to the Authority?

For thirty years, since the passage of the Tennessee Uniform Administrative Procedures Act in 1982, the staff of the TRA (formerly the Public Service Commission) has acted both as advisors to the agency decision makers and, when appropriate, as advocates participating as a party in agency proceedings. The two groups, advisors and advocates, operate independently as

[4] Because of the Company's small size and financial circumstances, the Company has up to thirty months to pay this amount at a rate of not less than $250 per month. See paragraph 23(i) of the Settlement Agreement.

[5] TRA Rule 1220-4-13-.07 requires wastewater utilities to furnish proof of financial security but, as explained in Rule 1220-4-13-.07(5), gives the Authority discretion in determining the type and amount of security necessary to satisfy the rule.

required by state statutes and case law.[6] The staff members acting as advocates conduct investigations, present testimony and engage in settlement negotiations with the other parties. As the agency's representatives, the staff's role is to represent the public interest, balancing the rights of utilities and ratepayers and advocating any course of action which the Authority is empowered to take, including the approval of a settlement.[7] It is then up to the agency to determine whether the staff's recommended action is reasonable and in the public interest. This case is no different from hundreds of others.

The Consumer Advocate argues that the Staff has no authority to participate as a party in this case. The Advocate's brief does not discuss or even mention the statutes and multiple court rulings which require the agency to designate an advocacy staff when needed especially, as here, when the agency has opened a "show cause" docket to investigate and, potentially, prosecute a regulated utility.

The role of the Staff in this case is not unique to the TRA. It is common practice at regulatory agencies throughout State government. It is unlikely that the Attorney General has ever told (or ever would tell) other agencies that this practice is not authorized by state law.

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[6] Prior to passage of the UAPA, the agency's staff not only participated in contested cases as a party but also acted as confidential advisors to the agency members. The Act, however, required the agency to separate its investigative or prosecutorial staff from its advisory staff and prohibited ex parte communications between advisors and advocates. T.C.A. § 4-5-303 (requiring the separation of functions) and § 4-5-304(a) (prohibiting ex parte communications). The separation of staff into advisory and advocacy roles is also well established in case law. See Martin v. Sizemore, 78 S.W. 3d 249 (Tenn. Ct. App. 2001); Tennessee Consumer Advocate v. Tennessee Regulatory Authority and United Cities Gas Company (Tenn. Ct. App. 1997) 1997 WL 92079 (copy attached); and Consumer Advocate v. Tennessee Regulatory Authority and Nashville Gas Company (Tenn. Ct. App. 1998) 1998 WL 685436 (copy attached).

[7] As the Court of Appeals has explained, ratemaking is "essentially a value judgment made by the Commission in the exercise of its sound regulatory judgment and discretion." Tenn. Cable Tele. Association v. Tenn. Public Service Comm., 844 S.W. 2d 151, 159 (Tenn. Ct. App. 1992). When the staff participates as a party in a contested case and negotiates a settlement, the agency's "judgment and discretion" is exercised in the first instance by the staff subject to the approval of the settlement by the Authority. The Advocate's argument (brief, at 10-11) that the Staff and Company cannot engage in "give and take" negotiations in reviewing the Company's expenses and arriving at a settlement shows a lack of understanding of how rates are set.

When an agency initiates an enforcement proceeding, separation of the advocacy and advisory staff is not only authorized, it is required.

II. Is the TRA prevented by the doctrines of res judicata or collateral estoppel from approving the Settlement Agreement? [8]

Ratemaking is a legislative, not a judicial function. Knoxville v. Knoxville Water Co., 212 U.S. 1, 8 (1904) ("The function of ratemaking is purely legislative in character.") Therefore, it has long been held that the doctrines of res judicata and collateral estoppel do not apply to ratemaking in general or the TRA in particular. See United Cities Gas v. Public Service Commission, 789 S.W.2d 256, 259 (Tenn. 1990). ("The administrative body is and must be free to change its mind. . . .") The Advocate's brief cites (at 12) the United Cities case as support for the statement that TRA rate orders "are subject to the effects of res judicata and collateral estoppel." The case holds the opposite.[9] A copy of the case is attached.

III. Does the settlement violate the filed rate doctrine or constitute illegal, retroactive ratemaking?

As discussed, the Settlement requires Berry's Chapel to account for all money collected from customers without TRA approval. The money will either be refunded, placed in an escrow account, or spent to benefit customers. All of this relief is prospective; no customer is being re-

[8] While arguing that the Company is legally barred from seeking recovery of additional flood-related expenses, the Advocate also overlooks the fact that the Authority has already ruled that the Company may do so. In an Order issued June 25, 2013, in Docket No. 13-00052, the Authority stated that "if additional expenses are incurred which are specifically related to the May 2010 flood, Berry's Chapel may petition the Authority for possible recovery."

[9] In United Cities, a gas utility litigated and lost the issue of whether it could purchase the Franklin city gas system and write up the value of the assets to equal the purchase price. Two years later, the utility re-litigated the Franklin issue. Nothing had changed, and the Commission did not change its ruling, although the agency's opinion noted that the Commission "is not legally bound by its prior decisions." Id., at 258. The Supreme Court agreed, holding that it is "undoubtedly true" that the Commission "is free to reverse course if public policy demands it." Id., at 259. The Court explained that the agency is "free to change its mind" even if there has been no change in the facts or the law as long as the agency's new decision is not arbitrary and is supported by substantial and material evidence. Id.

billed for prior services. Therefore, this is not retroactive ratemaking nor does it violate the filed rate doctrine.

The Tennessee Court of Appeals ruled in 1994 that, as long as the TRA adjusted rates prospectively, the agency could order rate refunds without violating the prohibition against retroactive ratemaking. AARP v. Tenn. Public Service Commission, 896 S.W. 2d 127 (Tenn. Ct. App. 1994). This case modified earlier decisions, relied upon by the Advocate, which appeared to hold that the agency could not order rate refunds under any circumstances. Despite the AARP ruling, the Consumer Advocate subsequently filed three appeals of TRA orders allowing a utility to recover losses from a prior period. Each time, the Advocate argued that the Authority had engaged in retroactive ratemaking, and each time the Advocate lost.[10] None of those cases is mentioned in the Advocate's brief which relies on a Tennessee case decided in 1984 (see footnote 98) but does not mention any of the Tennessee cases addressing the retroactive ratemaking issue since that time. The most recent, last year's Chattanooga Gas decision, expressly held that a TRA decision to allow a utility to recoup past legal expenses was not retroactive ratemaking.[11] Chattanooga Gas, supra, at 32.

IV. Does the Authority have the power to approve the Settlement Agreement without conducting a full rate case?

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[10] Consumer Advocate v. Bissell, (Tenn. Ct. App. 1996) 1996 WL 482970; Consumer Advocate v. TRA, (Tenn. Ct. App. 2000) 2000 WL 13794; and Consumer Advocate v. Tenn. Regulatory Authority, (Tenn. Ct. App. 2012), 2012 WL 1964593, referred to hereafter as the Chattanooga Gas case. Copies of all these cases are attached.

[11] The Advocate also argues that the Settlement Agreement violates the "filed rate doctrine," which holds that utilities must charge their tariffed rates. Here, it is not disputed that Berry's Chapel charged rates without Authority approval, nor is it disputed that every dollar of those excess charges has been accounted for and is being returned to the customers who paid it or spent to benefit the customer body as a whole. It is not clear from the Advocate's brief how this violates the filed rate doctrine.

This, too, is an argument the Consumer Advocate made and lost last year in the Chattanooga Gas case. The Court held that the Authority has the power to allow a utility to increase rates "in a non-rate proceeding," ie., a docket that impacts rates but is not a general rate case, and observed that the Authority has done so on several occasions. Id., at 29-31. Consistent with the Authority's rulings in Docket 08-00060 (odor control) and Docket 11-00180 (flood damages), the Staff and the Company have agreed that the Company has incurred additional expenses for odor control and the recovery of flood damages and that the Company should be allowed to recover those expenses from ratepayers without having to file a general rate case. In sworn testimony, Ms. Underwood and Mr. Buckner explain that they have investigated the Company's expenses for odor control and the recovery of flood damages and concluded that the majority of those costs[12] are recoverable from customers.[13] The Advocate and the Advocate's expert witness disagree.[14] On September 9, there will be an evidentiary hearing at which all parties will be able to present evidence in support of, or in opposition to, the Settlement

[12] The Staff accepted $40,074.92 in odor control costs out of $69,131.75 submitted by the Company. The parties also agreed to reduce the legal expenses from $20,922.50 to $19,781.25. Underwood, at 12-13.

[13] The Advocate argues that the Staff and Company witnesses do not specifically use the words "prudent" or "just and reasonable" to describe these allowable expenses. The witnesses did, however, conclude that the expenses supported the utility's operations, benefited ratepayers, and are recoverable from customers. Underwood, at 3; Buckner, at 6-7. That testimony and the parties' agreement in the Settlement that these expenses are recoverable from customers is an implicit acknowledgment that the witnesses found that the expenses are prudent, just and reasonable. The Advocate, of course, has the opportunity to explore this point further during cross examination of Ms. Underwood and Mr. Buckner.

[14] The Advocate's attorney argues in the brief that some of the Company's legal expenses are not reasonable related to the Company's petition to recover costs to repair flood damage. These arguments appear to be copied, largely verbatim, from a filing by the Consumer Advocate in Docket 13-0052 ("Position of the Consumer Advocate," filed May 3, 2013). That filing, which was struck by the Authority because it was filed late, addresses the invoices submitted by the Company and questions whether the Company attorney's time was properly allocated. Three weeks later, Ms. Underwood filed her testimony and exhibits which included not only the invoices but the actual, handwritten timesheets showing how the attorney's time was allocated between flood issues and other matters. In her testimony, Ms. Underwood explained (at 14) that "if you looked at the invoices only" and not at the timesheets, one would get a misleading impression of how the legal expenses were allocated.

Agreement, and argue whether the overall Settlement is reasonable and in the public interest.[15] That is all the law requires. As the Court held in Chattanooga Gas, the Authority does not have to open a general rate case in order to allow a utility to recoup unusual expenses that are not covered in basic rates. The Advocate is just re-litigating the argument.

V. Does the Authority have the power to approve this Settlement without the consent of the Consumer Advocate?

This argument has previously been addressed by the Staff and the Company. See "Motion to Strike the CAD's 'Statement of Positions and Claims,'" filed July 8, 2013. As discussed in that filing, there is a formal Opinion of the Attorney General, issued in 2011, holding that an agency may approve a settlement between the agency and a regulated party "over the objection of an intervenor if the agency determines that the settlement is reasonable and the public interest is protected." Opinion, at 1. The Advocate cannot evade that holding,[16] and there is no need to repeat the earlier discussion of this issue. In a nutshell, the Authority has as much right to approve this Settlement Agreement over the Advocate's objection as the agency would to approve it if the Advocate had elected not to intervene in the first place. The agency's statutory responsibilities remain the same. In either case, the only issue is whether the Authority finds that the Settlement Agreement is "reasonable and the public interest is protected." If the Authority so

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[15] As discussed in footnote 7, supra, ratemaking is an exercise in judgment, not arithmetic. The agency "decides that which is just and reasonable. That is the litmus test—nothing more, nothing less." CF Industries v. Tenn. PSC, 599 S.W. 2d 536, 543 (Tenn. 1980). Whether the Advocate agrees or not with how Ms. Underwood and Mr. Buckner handled each invoice, the issue before the agency is the overall reasonableness of the resulting Agreement.

[16] The Consumer Advocate's brief (at 39-45) argues that even if the Authority approves the Settlement Agreement, that approval will not resolve the "claims" of ratepayers for additional refunds. The language used by the Advocate in describing these claims implies that individual ratepayers have a property interest in the rates they pay to regulated utilities. That is incorrect. When the agency sets a rate, the decision is binding on all ratepayers. "Ratemaking is a legislative function. It is not an adjudicatory proceeding affecting the vested property rights of individual ratepayers." Consumer Advocate Division v. Bissell, supra, at p.4 (copy attached).

finds, it makes no difference whether the Advocate agrees. Otherwise, the Advocate, not the Authority, would be deciding this case.

Conclusion

For these reasons, Berry's Chapel asks that the Settlement Agreement be approved.

Respectfully submitted,

BRADLEY ARANT BOULT CUMMINGS LLP

By: _____

Henry Walker (B.P.R. No. 000272)
Bradley Arant Boult Cummings, LLP
1600 Division Street, Suite 700
Nashville, TN 37203
Phone: 615-252-2363
Email: hwalker@babc.com

CERTIFICATE OF SERVICE

I hereby certify that on the 12th day of August, 2013, a copy of the foregoing document was served on the parties of record, via hand-delivery, overnight delivery or U.S. Mail, postage prepaid, addressed as follows:

Vance Broemel
Office of the Attorney General
Consumer Advocate and Protection Division
P.O. Box 20207
Nashville, TN 37202-0207

Shiva Bogarth
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, Tennessee 37243

HENRY WALKER

Not Reported in S.W.2d, 1997 WL 92079 (Tenn.Ct.App.)
(Cite as: 1997 WL 92079 (Tenn.Ct.App.))

Court of Appeals of Tennessee,
Middle Section, at Nashville.
TENNESSEE CONSUMER ADVOCATE,
Plaintiff/Appellant,
v.
TENNESSEE REGULATORY AUTHORITY AND UNITED CITIES GAS COMPANY, Defendant/Appellee.

March 5, 1997.

Appeal from the Davidson County Tennessee Public Service Commission, at Nashville, Tennessee.
Charles W. Burson, Attorney General & Reporter, L. Vincent Williams, Consumer Advocate Division, Nashville, for Plaintiff/Appellant.

H. Edward Phillips, III, Tennessee Regulatory Authority, Nashville, for Defendant/Appellee.

OPINION

TODD, Presiding Judge.

***1** The petitioner, Tennessee Consumer Advocate, has petitioned this Court for review of administrative decisions of the Tennessee Public Services Commission pursuant to T.R.A.P. Rule 12. By order entered by this Court on October 3, 1996, the review is limited to an order entered by the Commission on May 3, 1996. However, the circumstances stated hereafter require reference to an order previously entered by the Tennessee Public Service Commission on May 12, 1995.

The Parties.

Prior to June 30, 1996, the Public Service Commission controlled the charges of public utilities in Tennessee. On June 30, 1996, the Public Service Commission was discontinued by enactment of the Legislature which created the Tennessee Regulatory Commission which has been substituted for the Public Service Commission in proceedings before this Court.

By T.C.A. § 65-4-118, the Consumer Advocate Division of the Office of Attorney General and Reporter may with the approval of the Attorney General and Reporter appear before any administrative body in the interests of Tennessee consumers of public utility services.

United Cities Gas Company is a public utility which purchases and distributes natural gas through its pipelines to patrons in parts of Tennessee.

The Administrative Proceedings.

On January 20, 1995, United filed with the Public Utilities Commission (hereafter P.S.C.), an application for approval of a scheme of variable rates based upon the wholesale price of gas purchased from suppliers.

P.S.C. granted leave to the Consumer Advocate to intervene.

On May 12, 1995, the P.S.C. entered an order approving the proposed scheme on condition that an independent consultant be engaged to review the "mechanism" and report to the commission annually.

On October 31, 1995, United Gas submitted to the Commission for approval, a contract with Consulting & Systems Integration, providing that the work was to be performed by a Mr. Frank Creamer. Subsequently, United Gas requested that Anderson Consulting be substituted for Consulting Systems because Mr. Creamer had severed his connection with Consulting Systems and affiliated with Anderson.

The May 3, 1996, order of the Commission, which is the subject of this appeal, approved the contract with Anderson Consulting and thereby sat-

isfied all of the conditions for activation of the rate plan conditionally approved in the May 12, 1995 order.

On appeal, the Consumer Advocate presents ten issues for review. Only those which relate to the May 3, 1996, order will be considered.

The appellant's fourth, fifth, sixth and seventh issues are:

IV. The commission's action violated statutory provisions, was asked upon unlawful procedure, was arbitrary and capricious, or was clear error when it took judicial notice of a report prepared by a consultant of UCG.

V. The Consumer Advocate was denied an opportunity to be heard as to the propriety of taking judicial notice of the report.

VI. The Consumer Advocate division was not notified of the material noticed and afforded an opportunity to contest and rebut the facts or material so noticed.

***2** VII. A decision of the Tennessee Public Service Commission is void or voidable when agency members receive aid from staff assistants, and such persons received ex parte communications of a type that the administrative judge hearing officer or agency members would be prohibited from receiving, and which furnish, augment, diminish or modify the evidence in the record in violation of Tenn.Code Ann. § 4-5-304(b).

At a hearing before the Commission on February 3, 1996, the following occurred:

Mr. Irion: We have the independent consultant here. Does the Commission on wish to hear from him?

Chairman: I think what we have agreed to is just summarize his testimony.

Mr. Williams: He has not made any testimony, and-

Mr. Irion: He has only filed a report, and he is not technically our witness or-

Mr. Williams: I think he is their witness. They chose him and paid for him. We did not have any choice. The Consumer Advocate was not given any choice in the matter who was going to be the witness.

Chairman: The Commission can take judicial notice of that, that record. That's our record.

Com. Hewlett: This is our consultant.

Mr. Hal Novak: That's correct, sir. The Commission staff chose this consultant.

Chairman: We can take judicial notice of that and it can referred to in your argument here.

Mr. Williams: I would say that the Commission staff approved the consultant after the company selected the consultant.

Mr. Novak: That's not true, sir.

Chairman: Well, now wait a minute now, fellows. We can take judicial notice, and will take judicial notice of all our records and reports like that to the Commission and you can refer to that in your argument.

Mr. Williams: What I would also like to do, Commissioner, maybe we need to have a longer period of time. I would like to know what the staff's position-it was indicated that the staff had a position that the rule operated effectively, that the Commissioners had obviously heard and were considering. I would like disclosure under the statute of the staff's position on why they think that it operates correctly.

Com. Hewlett: Well, that would be in my way of thinking not impossible to get into the record, but very difficult it is most appropriate, as I understand the law, for us to discuss withour technical

staff. That's the reason that the Consumer Advocate Division was created because of the ex parte concerns of when our staff were parties to the case and when they are not. Our staff, as I understand it, it not a party to this case, and they are a resource for us for analyzing anything that is before this Commission. In this case this situation. So, I think you are trying to make a party to the case somebody that is not.

Mr. Williams: No, sir, what we are trying to do is get all the salient information on the record. The statute explicitly, the UAPA explicitly requires that the Commission disclose when it has any of the position papers that are presented by the staff, and the Public Records Act does not prevent the disclosure of those items either.

***3** Chairman: We will rule on that at the beginning of the meeting at 1:30.

Mr. Williams: Okay.

Chairman: Well, we will evaluate that with our legal counsel, and rule on it before issuing an order or in the order in this manner.

The record of proceedings clearly indicates that the Commission considered a report of an expert despite the objections of the Consumer Advocate and his efforts to impeach the report by cross-examination of the expert. T.C.A. § 65-2-109(1) and (2), authorize the consideration of a broad spectrum of evidence. However, no authority is cited to empower the Commission to deny a protesting party access to all evidence considered by the Commission and opportunity to impeach it by cross-examination of the origin of such evidence.

The issue of consideration of documents and/or communications is not an issue of "judicial notice" or "administrative notice," but an issue of admissibility of evidence and procedural fairness in respect to notice of the matter to be considered and opportunity to cross-examine, or impeach the source or contradict the evidence to be considered.

It is elementary that administrative agencies are permitted to consider evidence which, in a court of law, would be excluded under the liberal practice of administrative agencies. Almost any matter relevant to the pending issue may be considered, provided interested parties are given adequate notice of the matter to be considered and full opportunity to interrogate, cross-examine and impeach the source of information and to contradict the information.

No error is found in the consideration of informal forms of communication. However, error is found in the failure to give timely notice of the communication with opportunity to question, cross-examine and impeach the source and contradict the information.

As illustrated by the above quotation from the record, the Commission was unfamiliar with basic rules of fairness in an administrative hearing.

Tenn.Code Ann. § 4-5-312(b)

Procedure of hearing. To the extent necessary for full disclosure of all relevant facts and issues, the administrative judge or hearing officer shall afford to all parties the opportunity to respond, present evidence and argument, conduct cross-examination, and submit rebuttal evidence, as restricted by a limited grant of intervention or by the pre-hearing order. (Emphasis added.)

Tenn.Code Ann. § 4-5-313(6)

Parties must be notified before or during the hearing, or before the issuance of any initial or final order that is based in whole or in part on facts or material noticed, of the specific facts or material noticed and the source thereof, including any staff memoranda and data, and be afforded anopportunity to contest and rebut the facts or material so noticed.

Tenn.Code Ann. § 4-5-304(a)(b)

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.

*4 (b) Notwithstanding subsection (a), an administrative judge, hearing officer or agency member may communicate with agency members regarding a matter pending before the agency or may receive aid from staff assistants, members of the staff of the attorney general and reporter, or a licensed attorney, if such persons do not receive ex parte communications of a type that the administrative judge, hearing officer or agency members would be prohibited from receiving, and do not furnish, augment, diminish or modify the evidence in the record. (Emphasis added.)

This Court concludes that the Commission commited a violation of basic principles of fairness in failing to afford the Consumer Advocate reasonable access to the materials to be considered and reasonable opportunity to cross-examinate or otherwise impeach the origin of such materials..

For the foregoing reasons, the order entered by the Public Service Commission on May 3, 1996, is reversed, vacated, and the cause is remanded to the Tennessee Regulatory Authority for such further proceedings and actions as it may deem appropriate including a reconsideration of the subject of the May 3, 1996, order of the Public Service Commission.

Should the Regulatory Authority reach a conclusion different from that expressed in the May 3, 1996, order of the Commission, the way may be opened for a further consideration of the subject matter of the May 26, 1995, order, in which event the authority will be free to examine the merits of the order and the proposal dealt with therein.

Of particular interest and concern are the propriety of omitting certain income from considering "fair return," of "rewarding" utility for keeping its expenses at the minimum, and of utilizing the services of an expert employed by the utility. These issues have not been discussed in this opinion because of the limitation of the scope of the appeal granted by this Court.

Costs of this appeal are assessed against the Tennessee Regulatory Authority.

REVERSED AND REMANDED.
CANTRELL and KOCH, JJ., concur.

Tenn.App.,1997.
Tennessee Consumer Advocate v. Tennessee Regulatory Authority
Not Reported in S.W.2d, 1997 WL 92079 (Tenn.Ct.App.)

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SEE COURT OF APPEALS RULES 11 AND 12

Court of Appeals of Tennessee.
CONSUMER ADVOCATE DIVISION, Petitioner/Appellant,
v.
TENNESSEE REGULATORY AUTHORITY; Nashville Gas Company, Respondents/Appellees.

No. 01A01-9708-BC-00391.
July 1, 1998.

Appeal No. 01-A-01-9708-BC-00391 Tennessee Regulatory Commission.
JOHN KNOX WALKUP Attorney General & Reporter.

L. VINCENT WILLIAMS Assistant Attorney General 425 Fifth Avenue North Nashville, Tennessee 37243 Attorney for Petitioner/Appellant.

H. EDWARD PHILLIPS, IIITennessee Regulatory Authority 460 James Robertson Parkway Nashville, Tennessee 37243-0505 Attorney for Respondent/Appellee Tennessee Regulatory Authority.

T.G. PAPPASJOSEPH F. WELBORN III 2700 First American Center Nashville, Tennessee 37238.

JERRY W. AMOS P.O. Box 787 Greensboro, North Carolina 27402 Attorneys for Respondent/Appellee Nashville Gas Company.

HENRY WALKER 414 Union Street, Suite 1600 Nashville, Tennessee 37219 Attorney for Intervening Appellant Associated Valley Industries.

OPINION

CANTRELL, J.

*1 This petition under Rule 12, Tenn. R.App. Proc., to review a rate making order of the Tennessee Regulatory Authority presents a host of procedural and substantive issues. We affirm the agency order.

I.

On May 31, 1996 Nashville Gas Company (NGC) filed a petition before the Tennessee Public Service Commission requesting a general increase in its rates for natural gas service. The proposed rates would produce an increase of $9,257,633 in the company's revenue. The Consumer Advocate Division (CAD) of the State Attorney General's office filed a notice of appearance on June 6, 1996 and Associated Valley Industries (AVI), a coalition of industrial users of natural gas, entered the fray on August 20, 1996.

The Public Service Commission was replaced on July 1, 1996 by the Tennessee Regulatory Authority (TRA), a new agency created by the legislature. By an administrative order, TRA laid down the procedure by which it would accept jurisdiction of matters previously filed before the Public Service Commission, and the parties successfully navigated the uncharted waters of the TRA to get the case ready for a final hearing on November 13, 1996.

At a scheduled conference on December 17, 1996, the TRA orally approved a general rate increase for NGC, effective January 1, 1997, that would produce approximately $4,400,000 in new revenue. When a final order had not been filed by December 31, 1996, NGC began charging the rates orally approved at the conference on December 17. On February 19, 1997 TRA filed its written order adopting the oral findings of December 17, 1996. The order allowed the increased rates "for service rendered on and after January 1, 1997."

II. The Procedural Issues

a.

Was the TRA required to appoint an administrative law judge or hearing officer to conduct the hearing?

The Tennessee Administrative Procedures Act

provides that a contested case hearing shall be conducted (1) in the presence of the agency members and an administrative judge or hearing officer or (2) by an administrative judge or hearing officer alone. Tenn.Code Ann. § 4-5-301(a). The CAD asserts that the TRA's order in this case is void because the agency did not follow the mandate of this statute.

The TRA, however, is also governed by an elaborate set of procedural statutes. *See* Tenn.Code Ann. § 65-2-101, et seq. Tenn.Code Ann. § 65-2-111 provides that the TRA *may* direct that contested case proceedings be heard by a hearing examiner, and we held in *Jackson Mobilphone Co. v. Tennessee Public Service Comm.,* 876 S.W.2d 106 (Tenn.App.1994), that the TRA's predecessor, the Public Service Commission, could conduct a contested case hearing itself *or* appoint a hearing officer. We think that decision is still good law and that it applies to the TRA.

b.

Did the TRA staff conduct its own investigation and improperly convey ex parte information to the TRA?

The CAD argues that the TRA violated two sections of the UAPA in the proceeding below: (1) the section prohibiting a person who has served as an investigator, prosecutor, or advocate in a contested case from serving as an administrative judge or hearing officer in the same proceeding, Tenn.Code Ann. § 4-5-303; and (2) the section prohibiting ex parte communications during a contested case proceeding, Tenn.Code Ann. § 4-5-304.

***2** As to the first contention, there is nothing in the record that supports it. The Regulatory Authority members sat as a unit to hear the proof in the hearing below. We have held that they were entitled to do so. There is no proof that any of them had served as an investigator, prosecutor, or advocate in the same proceeding.

As to the second contention, it is based on the CAD's suspicion that members of the TRA staff had taken part in an investigation of NGC, had prepared a report for the Authority, and had, in fact, continued to communicate with NGC and relay that information to the Authority members.

At the beginning of the hearing the Consumer Advocate moved to discover what he described as a report from the staff that augmented or boosted the position of one party or the other. He admitted that he did not know that such a report existed but that he believed it did, because of the past practice before the Public Service Commission.

The Authority chairman moved to deny the motion with the following explanation:

I believe that as a director I have a right to have privileged communication with a member of my staff for the purpose of understanding issues and analyzing the evidence in the many complicated proceedings that this Agency has to hear. I reject your allegation that I have abdicated my responsibility as a decision maker. I rely on my staff expertise as the law permits me to do so. Therefore, I move that your motion be denied.

The Agency members unanimously denied the CAD's motion.

On this part of the controversy we are persuaded that the TRA was correct. The TRA deals with highly complicated data involving principles of finance, accounting, and corporate efficiency; it also deals with the convoluted principles of legislative utility regulation. To expect the Authority members to fulfill their duties without the help of a competent and efficient staff defies all logic. And, we are convinced, the staff may make recommendations or suggestions as to the merits of the questions before the TRA. *See* Tenn.Code Ann. § 4-5-304(b). Otherwise, all support staff-law clerks, court clerks, and other specialists-would be of little service to the person(s) that hire them. We are satisfied that any report made by the agency staff based on the record before the TRA was not subject to the CAD's motion to discover it.

The other part of the CAD's contention is more troubling. It contains an assertion that members of the TRA staff were passing along to the TRA evidence received from NGC. We would all agree that such ex parte communications are prohibited. *See* Tenn.Code Ann. § 4-5-304(a) and (c).

In support of his contention Consumer Advocate called the manager of the utility rate division who testified that he did an investigation of NGC under an audit. At that point the parties engaged in a general discussion about the Authority's prior ruling that the staff members' advice could not be discovered. A question about whether his advice was based on anything other than the facts in the record was excluded after an off-the-record discussion, and the witness was asked only one other question. He answered "yes" when asked if he had talked with the company or company officials since the time of the audit. There were no questions bearing on the nature of the conversations, or whether the witness received or disseminated any information pertinent to the NGC proceeding.

*3 We cannot find on the basis of the evidence in this record that the Agency received any ex parte communications that were prejudicial to the CAD's position. We would add only one further point: that administrative agencies should ensure compliance with the Administrative Procedures Act.

c.

Did NGC unlawfully put its new rates into effect on January 1, 1997?

The CAD argues that since no written order had been entered allowing the rate increase, NGC had no authority to start charging the increased rates, and the TRA's February order amounted to retroactive ratemaking.

The TRA has the power to fix just and reasonable rates "which shall be imposed, observed, and followed thereafter" by any public utility. Tenn.Code Ann. § 65-5-201. But the statutory scheme-which is the same as it was during the existence of the Public Service Commission-recognizes that a public utility may set its own rates, subject to the power given to the TRA to determine if they are just and reasonable. Tenn.Code Ann. § 65-5-203(a). *See Consumer Advocate Division v. Bissell,* No. 01-A-01-9601-BC-00049 (Tenn.App., Nashville, Aug. 26, 1996). The increased rates may be suspended for an outside limit of nine months while the TRA conducts its investigation, *id.,* but after six months the utility may, upon notice to TRA, place the increased rates into effect. Tenn.Code Ann. § 65-5-203(b)(1). The authority *may* require a bond in the amount of the proposed annual increase. *Id.*

In this case, NGC filed its petition on May 31, 1996. Because the Public Service Commission was replaced by the TRA on July 1, 1996, NGC refiled the petition on July 29, 1996. The CAD argues that the petition, therefore, had not been pending for the six months period that would allow NGC to put the rates into effect.

Under the circumstances of this case, however, we think that argument exalts form over substance. The TRA had heard the proof, and in an open meeting had announced its decision to allow part of the rate increase to go into effect on January 1, 1997. While a written order had not been entered, NGC notified the TRA that it would put the approved rates into effect on the date specified in the TRA's oral decision.

In our view, the increased rates had been pending since May. The hiatus between May and July was caused by a massive overhaul of the state regulatory machinery, and that fact cannot be attributed to NGC. So, under the statutory scheme, NGC had the power to put the approved rates into effect on January 1, 1997.

In addition, Tenn.Code Ann. § 65-2-112 says "Every final decision or order rendered by the authority in a contested case shall be in writing, or stated in the record...." NGC could have used the TRA's oral decision as the basis for its action of putting the rates into effect. The decision had been

"stated in the record" on December 17, 1996. We add this caveat, however. The statute goes on to say that either a written or oral decision "shall contain a statement of the findings of fact and conclusions of law upon which the decision of the authority is based." We do not express an opinion on whether the December 17 oral decision complies with that mandate. But we do agree that findings of fact and conclusions of law are a necessary requirement for a meaningful review of an administrative agency's decision. *See Levy v. State Bd. of Examiners for Speech Pathology & Audiology,* 553 S.W.2d 909 (Tenn.1977).

III. The Substantive Issues

a. Hearsay

***4** The CAD argues that some of the evidence offered by NGC's expert on the projected increase in company expenses was based on rank hearsay. We notice, however, that Tenn.Code Ann. § 65-2-109 allows TRA to admit and give probative effect to any evidence that would be accepted by reasonably prudent persons in the conduct of their affairs. The same statute relieves the TRA from the rules of evidence that would apply in a court proceeding.

The CAD does not address the question of whether the evidence it calls hearsay is, nevertheless, of the kind that would be relied on by reasonably prudent persons in the conduct of their affairs. NGC argues that the evidence was not hearsay because it was based on the company records that are kept in the ordinary course of business. *See* Tenn. R. Evid. 801, 803(6). We need not decide whether the proffered evidence was hearsay because we are satisfied that the evidence was reliable and could be considered by the TRA. The TRA heard the objections to the evidence and the CAD's argument that its evidence on the same subject should have been received. The TRA chose NGC's evidence as more reliable. We find no fault with the TRA's decision on this issue.

b. Advertising

This is an issue on which the briefs of the principal parties seem to be speaking different languages. The following explanation is the best we can glean from the record. In 1984 the Public Service Commission adopted a rule that disallowed as a recoverable expense by a utility any "promotional or political advertising." The prohibition covered advertising for the purpose of encouraging any person to select or use gas service or additional gas service. It did not cover (among other things) advertising informing customers how to conserve energy or to reduce peak demand for gas, or advertising promoting the use of energy efficient appliances. *See* former Rule 1220-4-5-.45, Tenn. Regis.

In a 1985 proceeding involving a rate increase application by NGC, the Commission deviated from the rule and allowed advertising expenses up to .5% of revenues. In March of 1996 the Commission repealed 1220-4-5-.45 and proposed a new rule that would allow a utility to recover "all prudently incurred expenditures for advertising." Apparently the rule had not made it completely through the adoption procedure when the TRA heard this case below.

Nevertheless, based on proof of $1,486,000 in external advertising expenses, $800,000 in marketing personnel payroll and $300,000 in miscellaneous sales expenses, the TRA allowed the recovery of all but approximately half of the external advertising expenses. The CAD urged disallowance of all the related expenses except approximately $647,000 and NGC claims that the TRA erred in reducing the external operating expenses because there was no proof that they were imprudently incurred.

We think the TRA was justified in its conclusion on this issue. Based on the testimony in the record that the advertising expenses were incurred to meet competition, to add new customers on existing mains, and to get existing customers to use more gas, the TRA concluded that the rate payers benefited from at least part of the external advertising.

c. The Long Term Incentive Plan

***5** The TRA allowed NGC to recover approximately one-half of the cost of its Long Term Incentive Plan. The CAD opposes the allowance of any of this expense on the basis that the plan encourages executives to seek growth through rate increases instead of through performance gains. According to the CAD, the plan does not promote improved service.

NGC offered evidence, however, that the plan had increased employee efficiency and had reduced the number of company employees per customer in Tennessee. The savings amounted to $7 million annually in wages and salaries. The same witness rebutted the CAD witness who testified that the plan encourages employees to seek rate increases rather than improved efficiency.

None of the parties to the appeal cited any authority governing the allowance of incentive payments in utility rate cases. The proof included some references to cases in other jurisdictions where that state's utility commission had allowed either 100% of the incentive payments or some fraction thereof. The consensus seems to be to look at each plan on a case by case basis and view each plan in the context of the utility's total compensation package.

We do not think the TRA erred in the treatment of the long term incentive plan in this case.

d. Rate of Return

NGC requested a rate of return on equity in the range of 13% to 13.25%. The CAD requested an 11% rate of return and offered expert testimony showing that monthly compounding of the company's income would raise the rate of return to 11.60%. The TRA set a rate of return of 11.5%.

We fail to see how either side could make much of a case on appeal. The TRA's findings and conclusions are supported by evidence in the record that is both substantial and material. *See* Tenn.Code Ann. § 4-5-322(h). A proper rate of return is not a point on a scale, *Tennessee Cable Television Ass'n v. PSC,* 844 S.W.2d 151 (Tenn.App.1992), it covers a fairly broad range, as indicated by the testimony of the competing experts in this case. We affirm the TRA's decision on this point.

We take no position on the issue of the compounding effect of the company's receipts. It is a concept that is new to us in utility regulation, and its merits need to be explored more thoroughly than they have been in this record.

IV. The Rate Design

The intervenor, AVI, challenges the part of the TRA's order that raised the "tailblock" rate for gas supplied to NGC's largest interruptible customers. The tailblock rate is the lowest rate charged per unit and it applies to usage of over 9,000 decatherms per month.[FN1] NGC's petition did not seek any increase in the rates falling in this category. The CAD's proof proposed that any changes be spread to all customer classes, but the intervenor sought an overall rate decrease. AVI's witness testified that industrial rates were set well above costs and should not be increased The TRA's order increased the tailblock rate from $0.21 per decatherm to $0.228 per decatherm. The TRA said in its order:

> FN1. There are three other blocks in the interruptible industrial category of users. Block one applies to usage of 1-1,500 decatherms per month; block two covers the 1,501-4,000 category; and block three applies to the 4,001-9,000 category.

***6** After careful consideration of the testimony and exhibits of the parties, the Authority finds that the rate increase approved herein should be spread equally to all customers. It is the intent of the Authority to spread this increase to all ratepayers, including interruptible Sales customers, Transportation customers, and Special Contract customers, in order to minimize the overall impact of this rate change. In addition, the Authority concludes that the residential customer charge should be increased from $6.00 per month to $7.00 per month.

We think the question of whether to spread the

rate increase to all classes of users was within the discretion of the TRA. In *CF Industries v. Tenn. Pub. Serv. Comm.*, 599 S.W.2d 536 (1980), our Supreme Court said:

> Specifically, there is no requirement in any rate case that the Commission receive and consider cost of service data, or what 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.
>
> 599 S.W. at 542.
>
> * * *
>
> 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.
>
> 599 S.W. at 543.

We think it would be a rare case where the court would interfere with a rate increase spread evenly over all classes of users. If the rate design is inequitable it was not established in this proceeding. Therefore, a request that the rate increase be applied unevenly is, in fact, a request to change the rate design-on which the intervenor would have the burden of proof. A change would have to be shown by a greater amount of proof than appears in this record.

The TRA's order is affirmed and the cause is remanded to the Tennessee Regulatory Authority for enforcement. Tax the costs on appeal to the Consumer Advocate Division.

CONCUR: HENRY F. TODD, PRESIDING JUDGE, MIDDLE SECTION, WILLIAM C. KOCH, JR., JUDGE.

Tenn.App.,1998.
Consumer Advocate Division v. Tennessee Regulatory Authority
Not Reported in S.W.2d, 1998 WL 684536 (Tenn.Ct.App.), Util. L. Rep. P 26,665

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see, however, how the other spouse's position is worsened by the fact that a survivorship interest is now held by a third party. In order to convey a marketable title, a spouse must obtain the consent of the other spouse if the property is held by the entireties. If the survivorship interest is held by a third party, the spouse must obtain the consent of that party in order to convey a marketable title. The marketability of the title is the same, in either event.

The Court of Appeals is affirmed on the issues appealed from the chancery court and reversed on the issue of the survivorship interest. The cause is remanded to the Chancery Court of Davidson County for any further proceedings that may become necessary. Tax the costs on appeal to the appellees.

DROWOTA, C.J., and FONES, HARBISON and O'BRIEN, JJ., concur.

UNITED CITIES GAS COMPANY, Appellee,

v.

TENNESSEE PUBLIC SERVICE COMMISSION, Appellant.

Supreme Court of Tennessee, at Nashville.

April 23, 1990.

Gas utility appealed administrative denial of rate increase. The Equity Court, Davidson Conty, C. Allen High, Chancellor, remanded, and appeal was taken. The Supreme Court, O'Brien, J., held that Tennessee Public Service Commission's decision in petition for rate increase was final judgment, entitled to res judicata effect, until such time as utility was able to muster new evidence to warrant rate increase.

Reversed.

Administrative Law and Procedure ⇐501

Gas ⇐14.3(4)

Tennessee Public Service Commission's decision in petition for rate increase by gas utility was final, entitled to res judicata effect, until such time as utility was able to muster new evidence to warrant rate increase.

Henry Walker, Nashville, for appellant.

James L. Bomar, Jr., Jack M. Irion, Bomar, Shofner, Irion & Rambo, Shelbyville, for appellee.

OPINION

O'BRIEN, Justice.

These proceedings were initiated by a petition before the Tennessee Public Service Commission (Docket No. U-84-7333), for a rate increase by United Cities Gas Company, an investor owned utility, distributing gas in a number of Tennessee communities including Shelbyville, Columbia, Murfreesboro, Maryville, Alcoa, Morristown, Bristol, Union City, Franklin, and their environs. The Company is regulated by the Tennessee Public Service Commission pursuant to T.C.A. § 65-4-101, et seq.

In 1983 the Company purchased the City Gas System of Franklin, Tennessee for $1.4 million. In an order issued 30 November 1983 the Public Service Commission approved the sale with the express reservation that "any issue relating to future cost of service or inclusions in rate base shall be reserved and considered by the Commission in any future rate case filed by United Cities."

On 14 December 1984 the Company filed a petition for a rate increase to produce additional annual revenue in excess of $5,000,000. In an extensive order based on comprehensive findings of fact and conclusions of law the Commission ruled that the Company was entitled to additional annual revenue of approximately $2,500,000. This reduced amount was based in part on the Commission's determination of the value of

the Franklin City Gas System on the date of its purchase. They based this determination at "book value" which was defined as original cost less depreciation. Approximately three (3) pages of the order were devoted to the testimony of Robert Crenshaw who stated that in 1972 the Federal Revenue Sharing Act required the Tennessee Comptroller's Office to assume responsibility for the accounting and administering of municipal funds. Under guidelines laid down by the Comptroller's office he was hired by the City of Franklin to determine, among other things, the book value of the gas system. This entailed converting the accounting system to an accrual basis, arriving at a value for the fixed assets, either by their initial cost or by estimates, to establish the accumulated depreciation and fix the book value as of 1973. Book value was determined to be $700,000.

The Company filed a petition for reconsideration specifically requesting that it be allowed to recover from rate payers, prorated over a period of 8.75 years, the excess amount that the utility paid to buy the Franklin City Gas System over the original cost figure adopted by the Commission as the book value of the property at the time of its purchase by United Cities. The Commission denied the petition and reaffirmed their prior decision.

A petition for review was filed in the Chancery Court of Davidson County in accordance with the provisions of T.C.A. § 4–5–322. That court reviewed the record and the testimony presented before the Commission relative to the purchase of the Franklin City Gas System and found there was substantial and material evidence in support of the Commission decision to deny the rate increase. This judgment was appealed to the Court of Appeals and was dismissed on appellant's application on 29 October 1986. In the interval, on 21 August 1986 the Company filed a new petition with the Public Service Commission requesting another rate increase, based in part on the acquisition cost of the Franklin Gas Company. It was the stated purpose of the Company to persuade the Commission to change their method of establishing a rate base from the original cost approach and approve a rate based on the acquisition cost of newly acquired assets.

The 21 August 1986 petition (Docket No. U–86–7442), came on to be heard on 10 February 1987 before the Commission. One of the issues presented was the purchase of the Franklin Gas System. The Commission reviewed the prior proceedings and found that the issue was fully litigated both at the prior Commission hearing and in the Davidson County Chancery Court. The 10 June 1985 order and the 11 August 1985 order on the petition for reconsideration were both incorporated into the order rejecting the Company's application. The order reflected that no new evidence or arguments had been presented and both sides relied on the record developed in the previous hearing. It was concluded there was no reason for the Commission to reach a different result in the case. The Commission allowed a rate increase of approximately $2,500,000 based on other facets of the petition. This decision was taken to the Court of Appeals by the Company under the provisions of T.C.A. § 4–5–322, as amended by Public Acts 1986, Ch. 738, § 2.

The Court of Appeals posed the issues before that court to be (1) whether the matter was *res judicata;* (2) if not, whether the Commission's determination of the value of the Franklin Gas System was correct. On the issue of *res judicata* that court concluded that where the Public Service Commission was willing in its discretion, to make a *de novo* review of a matter already presented before it, the application of *res judicata* was wholly inappropriate and the Legislature intended that the petitioner should be protected by a judicial review on the sufficiency of the Commission's decision. On the second issue the court concluded "that the Commission's refusal to allow United Cities to capitalize costs that had been expensed in order to increase the book value of the Franklin Gas System was supported in the record as a whole by substantial and material evidence." They affirmed that part of the Commission's order. They held that the Public Service Commission had failed to

make any findings concerning the proper rate of depreciation for the Franklin Gas Company prior to 1970 and that the Commission's order did not comply with the mandate of T.C.A. § 4–5–314(c) and (d). They remanded the case to the Commission "for the inclusion in its order of the findings and conclusions that support the rate of depreciation that should be applied to the original cost of the Franklin Gas System."

The Court of Appeals recognized that final decisions of State administrative agencies are *res judicata* when the agency action under review is of a judicial nature, citing *United States v. Utah Construction and Mining Company,* 384 U.S. 394, 86 S.Ct. 1545, 16 L.Ed.2d 642 (1966), as seminal authority. They took the view that the Tennessee Public Service Commission failed to meet the criteria stated in that case on the basis that it has been declared an administrative board and not a court, and that its power to fix rates is administrative and not judicial. The basic reasoning of the court was that none of the orders of the Public Service Commission in this case were of a final or conclusive nature. They reached this conclusion, as stated in the opinion, on the premise that "Both sides agree that the Commission is not bound by its prior decisions; as the Commission's order of February 13, 1987 put it: 'while an administrative agency is not legally bound by its prior decisions, the Commission should give substantial weight to a recent order which addresses in detail the same facts and legal arguments presented here ...' "

In reference to this issue we find the Commission order to say a great deal more than the Court of Appeals seems to have found. In pertinent part the Commission order reads as follows:

> "As explained during the hearing, this issue was fully litigated—both at the Commission and in the Davidson County Chancery Court—during the Company's last rate proceeding in May, 1985. The Commission and the court both held that the stockholders of United Cities, not its rate payers, should pay for the Company's decision to buy the Franklin Gas System at twice its book value. 'The system is just passing from one owner to another—at a 100% profit,' the Commission wrote, 'and the rate payers are being asked to pay the bill.'
>
> The best reasons for reaffirming the agency's decision are found in the written decisions of the Commission and the court which discuss the controversy in detail. We incorporate here both the order of June 10, 1985, and the order upon reconsideration issued August 11, 1985, insofar as those orders addressed the Franklin issue.
>
> No new evidence or arguments have been presented; both sides have relied on the record developed in the previous hearing.... Therefore, there is no reason for this Commission to reach a different result in this case. While an administrative agency is not legally bound by its prior decisions, the Commission should give substantial weight to a recent order which addresses in detail the same facts and legal arguments presented here. Otherwise, there would be no end to litigation and no consistency in regulation.
>
> ...
>
> The Commission again rejects the Company's argument. ..."

The Court reasoned that "[t]he Public Service Commission heard United Cities argue the valuation of the Franklin System three times—the 1985 hearing, the petition to rehear, and the 1986 hearing. The Commission could have changed its holding at any point, and could do so at any time if United Cities brings the matter before it again. In these circumstances the ruling of the Commission obviously can have no *res judicata* effect, since they are never truly final and conclusive. And even if this were not the case, the Commission in setting rates does not act in a judicial capacity, thus failing to meet the test in *Utah Construction,* supra." [1]

1. The petition for a rate increase was filed on 21 August 1986, heard by the Commission on 21 January, 1987, was considered by the Commission at a public meeting on 10 February 1987,

The court overlooked the fact that each of the orders of the Commission contain all of the indicia of a final order, required by statute. The order of the Commission from which this appeal was taken shows on its opening page that the case was the result of a merger of United Cities Gas Company and Tennessee–Virginia Energy Corporation. A rate petition which had been filed by Tennessee–Virginia prior to the merger had been withdrawn. The record of the proceedings clearly shows that a rate increase in excess of $2,000,000 was granted for various reasons the Commission approved but that insofar as the Franklin Gas System was concerned the application was clearly rejected without the introduction of any evidence.

The lower court took the approach that the Public Service Commission is free to reverse course if public policy demands it. Undoubtedly this is true, however it does not mean that a petitioner before the Commission for a rate increase is not bound by an order of the Commission until such time as new evidence or the public interest warrants a change of policy. The Court takes a similar view of the Commission's reasoning that even if United Cities is not bound by previous Commission orders, it is precluded from violating the prior judgment of the chancery court. They theorize that the result of such a situation would be to allow the Commission to rehear a particular rate case *ad infinitum*, while limiting the regulated utility to only one appeal. This is the precise situation which exists. The Company is bound by the ruling of the Commission until such time as it may be able to muster new evidence to warrant a rate increase. The Commission cannot arbitrarily establish a change of policy or change of rate. It is bound by the provisions of the Administrative Procedures Act and subject to judicial review, in accordance with the strictures of Chapter 5, Title 4 of Tenn.Code Anno., prescribing Administrative Rules and Procedure.

We think the Court of Appeals reached a correct conclusion in stating that the Legislature, in passing the Administrative Procedure Act, intended to provide for judicial review of administrative orders whenever made, ... and a petitioner is entitled to a review of whether the determination meets the standards set out in T.C.A. § 4–5–322(h). When an administrative decision is appealed, the courts are merely determining whether that decision is supported by substantial and material evidence and if or not it exceeds constitutional or statutory limits. The administrative body is and must be free to change its mind and, if there is substantial and material evidence to justify the change, the courts have no reason to overturn the new holding. Those persons, as defined in T.C.A. § 4–5–102(9), who are aggrieved by such a final decision, are entitled to file a petition for review, if it be a decision of the Public Service Commission, to the Middle Division of the Court of Appeals who must conduct the review in accordance with T.C.A. § 4–5–322. See *Public Service Commission v. General Telephone Company, etc.*, 555 S.W.2d 395 (Tenn.1977).

We are of the opinion the Court of Appeals erred in finding that the Public Service Commission considered the evidence *de novo* in the Franklin Gas System case. The record does not support that conclusion. We conclude that the Court erred in remanding the case for further compliance with T.C.A. § 4–5–314. See *Public Service Commission v. General Telephone Company, etc.*, supra; *CF Industries v. Tennessee Public Service Commission*, 599 S.W.2d 536 (Tenn.1980); *Powell Telephone Company v. Tennessee Public Service Commission*, 660 S.W.2d 44 (Tenn.1983).

The judgment of the Court of Appeals is reversed. The final order of the Public Service Commission is affirmed. The case is remanded to that agency for any further proceedings required. The costs are assessed against the appellee, United Cities Gas Company.

DROWOTA, C.J., and FONES, COOPER and HARBISON, JJ., concur.

apparently the order was entered on 13 February 1987.

Not Reported in S.W.2d, 1996 WL 482970 (Tenn.Ct.App.), Util. L. Rep. P 26,561
(Cite as: 1996 WL 482970 (Tenn.Ct.App.))

H

SEE COURT OF APPEALS RULES 11 AND 12

Court of Appeals of Tennessee.
CONSUMER ADVOCATE DIVISION, Office of the Attorney General State of Tennessee, Petitioner/Appellant,
v.
Keith BISSELL, Chairman; Steve Hewlett, Commissioner; Sara Kyle, Commissioner; Constituting the Tennessee Public Service Commission, Respondents/Appellees.

No. 01-A-01-9601-BC00049.
Aug. 28, 1996.
Rehearing Overruled Sept. 18, 1996.

APPEALED FROM THE PUBLIC SERVICE COMMISSION AT NASHVILLE, TENNESSEE
Charles W. Burson, Attorney General & Reporter Commission, Michael E. Moore, Solicitor General, David W. Yates, Associate Consumer Advocate, Nashville, Tennessee, for petitioner/appellant.

H. Edward Phillips, III, Tennessee Public Service, Nashville, Tennessee, for respondents/appellees.

William C. Bovender, T. Arthur Scott, Kingsport, Tennessee, James R. Bacha, One Riverside Plaza, Columbus, Ohio, for Kingsport Power Company.

OPINION

CANTRELL, Judge.

*1 The only question in this case is whether the Public Service Commission exceeded its authority by approving a tariff which allows Kingsport Power Company to pass its purchased power costs along to its customers without going through a ratemaking proceeding. We affirm the action of the Public Service Commission.

I.

Kingsport Power Company (KPC) furnishes electric power to retail customers in upper East Tennessee. It buys its electricity from an affiliated company, Appalachian Power Company. Both companies are wholly owned by American Electric Power (AEP).

The price KPC pays Appalachian for electric power is regulated by the Federal Energy Regulatory Commission (FERC), and state regulatory commissions must accept the FERC-approved rates as reasonable. *Nantahala Power & Light v. Thornburg,* 476 U.S. 953, 90 L.Ed.2d 943, 106 S.Ct. 2349 (1986). Under the FERC rules, however, Appalachian may put its increased rates into effect while FERC conducts its investigation. If upon concluding its investigation, FERC decides that the rate increase was not justified, Appalachian is required to refund the amount of the increase to KPC, with interest.

Historically, when Appalachian increased its rates to KPC, KPC would file an application with the Tennessee Public Service Commission (PSC) for an increase in its retail rates to its customers. The PSC would then conduct a ratemaking proceeding under Tenn.Code Ann. § 65-5-203.

In 1992 the Commission suggested that its staff and KPC work out a rule or a tariff that would allow the increased power costs to be passed along to KPC's customers without going through a formal ratemaking proceeding. On November 14, 1994, KPC petitioned the PSC to implement a tariff called a purchased power adjustment rider. After several skirmishes with the Consumer Advocate Division of the Attorney General's Office and with the Kingsport Power Users Association, the Commission entered a final order on November 30, 1995 approving the tariff. As we have noted, the tariff allows KPC to raise its rates by a formula in the tariff to pass the increased cost of power along to its customers. In the event KPC receives a refund after a final order from FERC, KPC is required to pass the

refund along to its customers as well.

II.

Ratemaking In General

A public utility has the authority to set its own rates-subject to being regulated by the legislature or by a body delegated the legislative power. *See* 64 Am.Jur.2d *Public Utilities* § 81; 133; 240:

> Until the legislature or other body having the right to prescribe the rates to be charged by public utilities has exercised this power, the rates are the subject of contract between the corporation and its patrons....

Id. § 81.

The legislative control over public utility rates at the time this controversy arose was expressed in Part 2 of Title 65 Chapter 5 of the Tennessee Code.[FN1] The first section of that chapter provided:

> FN1. We should point out that the Public Service Commission was abolished by the legislature and replaced by an appointed body, the Tennessee Regulatory Authority. See Acts 1995, ch. 305 (effective July 1, 1996).

> The commission has the power after hearing upon notice, by order in writing, to fix just and reasonable individual rates, joint rates, tolls, fares, charges or schedules thereof, as well as commutation, mileage, and other special rates which shall be imposed, observed, and followed thereafter by any public utility as defined in § 65-4-101, whenever the commission shall determine any existing individual rate, joint rate, toll, fare, charge, or schedule thereof or commutation, mileage, or other special rates to be unjust, unreasonable, excessive, insufficient, or unjustly discriminatory or preferential, howsoever the same may have heretofore been fixed or established....

*2 Tenn.Code Ann. § 65-5-201.

That chapter also provided:

> (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 commission 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 commission shall take into account the safety, adequacy and efficiency or lack thereof of the service or services furnished by the public utility. The commission 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 commission shall have approved the increase, change, or alteration; provided, that if the investigation cannot be completed within three (3) months, the commission 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 commission 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 commission 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 commission decision thereon upon notifying the commission, in writing, of its intention so to do; provided, that the commission may require the utility to file with the commission a bond in an

amount equal to the proposed annual increase conditioned upon making any refund ordered by the commission as hereinafter provided.

Tenn.Code Ann. § 65-5-203(a)(b)(1).

Thus the legislature has recognized that a public utility may set its own rates, subject to the PSC's power to suspend the rates for a certain period of time while it makes the utility prove that the rates are just and reasonable. *Cumberland Tel. & Tel. Co. v. Railroad and Public Utilities Commission,* 287 F. 406 (M.D.Tenn.1921). If the utility fails to carry that burden, the agency has the additional authority to fix rates that meet the just and reasonable criteria. *CF Industries v. Tennessee Public Service Commission,* 599 S.W.2d 536 (Tenn.1980).

***3** Under these statutes the rates charged by a public utility are not always the product of a ratemaking proceeding in the Commission. New tariffs automatically become effective unless the Commission elects to suspend them while conducting an investigation.[FN2] Therefore, there is nothing inherently wrong in KPC's power costs being passed along to its customers without a ratemaking proceeding in the Commission.[FN3]

FN2. The investigation, or ratemaking proceeding, would then be conducted according to the contested case provisions of the Administrative Procedures Act. Tenn.Code Ann. § 4-5-301.

FN3. We should note also that the Commission has the authority at any time to investigate any public utility's earnings, Tenn.Code Ann. § 65-5-201, and the Consumer Advocate may request such an investigation. Tenn.Code Ann. § 47-18-114.

III.

Retroactive Ratemaking

The Consumer Advocate argues, however, that the Commission's order is illegal because it amounts to retroactive ratemaking. This conclusion is drawn from the fact that if FERC later finds that the increase it allowed Appalachian was unjustified, Appalachian must refund any overpayment to KPC and the tariff requires KPC to pass the refund along to its customers.

This court has consistently held that the Commission does not have the authority to approve temporary or tentative rates subject to refund. In *South Central Bell v. Tennessee Public Service Commission,* 675 S.W.2d 718 (Tenn.App.1984) we said that the Commission's power to order refunds was limited to that expressly stated in Tenn.Code Ann. § 65-5-203. (The conditions described in that section are not involved here.)

We are of the opinion, however, that under the circumstances of this case, the PSC had the power to approve a tariff with a contingent refund provision. The tariff allows KPC to pass its increased power costs along to its customers, but it also requires KPC to give back to its customers that part of the increase (if any) that is refunded by Appalachian to KPC. If our analysis in Part II of this opinion is correct, the only offending part of the tariff is the refund provision. Otherwise, the tariff operates prospectively and comes within the powers granted the PSC by the legislature.

But, what makes this case different from *South Central Bell v. Tennessee Public Service Commission,* supra, is that the refund in this proceeding is merely the third step in a larger proceeding, the first two steps of which are governed by federal law. First, the PSC must accept the FERC-regulated cost of KPC's power purchased from Appalachian. Then, Appalachian must refund to KPC that part of the cost found by FERC to be unreasonable after it concludes its investigation. The third step, the refund included in KPC's tariff, is necessary to complete the obvious intent of the federal scheme to return the refund to the class that ultimately has had to pay it. If we struck the refund provision in the tariff, KPC would receive the refund and keep it.

We should note, also, that the problem would

be no different if KPC were required to go through a ratemaking proceeding before beginning to collect its increased power costs. The question of what could be done with a refund received by KPC after the new rates had gone into effect would still have to be answered. Because a refund order by the PSC would amount to retroactive ratemaking, KPC could not be forced to account for the refund to its customers.

IV.

Due Process

*4 The Consumer Advocate also argues that the tariff violates the ratepayers' right to due process. This argument is based on the part of Tenn.Code Ann. § 65-5-201 that says "the Commission has the power after hearing upon notice" to fix just and reasonable rates. We think, however, that the notice required by that section is notice to the utility. When the PSC exercises its statutory authority to modify the utility's posted rates the utility is entitled to the statutory notice and hearing.

Whether notice and a hearing in proceedings before a public service commission are necessary depends chiefly upon the statutory or constitutional provisions applicable to such proceedings, which may make notice and hearing prerequisite to action by the commission, and upon the nature and object of such proceedings, that is, whether the proceedings are, on the one hand, legislative and rule-making in character, or are, on the other hand, determinative and judicial or quasi-judicial, affecting the rights and property of private or specific persons.

64 Am.Jur.2d *Public Utilities* § 266.

Ratemaking is a legislative function. *See* 64 Am.Jur.2d *Public Utilities* § 240. It is not an adjudicatory proceeding affecting the vested property rights of the individual ratepayers. *Hatten v. City of Houston,* 373 S.W.2d 525 (Tex.App.1963). *(See also Cope v. Bethlehem Housing Authority,* 514 A.2d 295 (Pa.1986) on the general question of what process is due when an agency deals with non-vested rights). Therefore, since it is a legislative function, a change in rates by the PSC does not require notice to the individual ratepayers.

We hold that the tariff does not violate the due process rights of the rate-payers because it raises or lowers their rates without a hearing.

The order of the Commission is affirmed and the cause is remanded for any further proceedings that may become necessary. Tax the costs on appeal to the State.

LEWIS and KOCH, JJ., concur.

Tenn.App.,1996.
Consumer Advocate Div. v. Bissell
Not Reported in S.W.2d, 1996 WL 482970 (Tenn.Ct.App.), Util. L. Rep. P 26,561

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Only the Westlaw citation is currently available.

SEE COURT OF APPEALS RULES 11 AND 12

Court of Appeals of Tennessee.
CONSUMER ADVOCATE DIVISION, on Behalf of TENNESSEE CONSUMERS and the Attorney General of Tennessee, Petitioner/Appellant,
v.
TENNESSEE REGULATORY AUTHORITY, Respondent/Appellee.

No. M199902151COAR12CV.
Jan. 10, 2000.

Appealed from the Tennessee Regulatory Authority at Nashville, Tennessee.
Paul G. Summers Attorney General & Reporter, Michael E. Moore, Solicitor General, L. Vincent Williams, Assistant Attorney General, Nashville, TN, for appellant.

J. Richard Collier, H. Edward Phillips, Tennessee Regulatory Authority, Nashville, TN, for appellee Tennessee Regulatory Authority.

Guy M. Hicks, Patrick W. Turner, Nashville, TN, Bennett L. Ross, Atlanta, GA, for the appellee BellSouth Telecommunications, Inc.

OPINION

CANTRELL.

***1** After this court remanded a prior appeal saying that "the Tennessee Public Service Commission ... should have approved BellSouth's application for a price regulation plan based on BellSouth's rates existing on June 6, 1995", the Tennessee Regulatory Authority entered an order approving a price regulation plan based on the data used in the 1995 application. The State Attorney General's Consumer Advocate Division levels a broad attack on the order, asserting that this court's prior order did not mandate the result below, and that the order violates state and federal law. We hold that the Authority was not required by our prior order to take the action it took but that the order was within the Authority's discretion. Therefore, we affirm.

I.

We refer to our prior opinion in *BellSouth Telecommunications v. Greer,* 972 S.W.2d 663 (Tenn.Ct.App.1997) for the facts leading up to the approval of price regulation plans for local telephone companies. As that opinion recites, BellSouth applied for a price regulation plan on June 20, 1995 and an audit of BellSouth's Form PSC-3.01 report of March 31, 1995 showed a rate of return within the range set by the Public Service Commission's order in 1993. Nevertheless, the Commission's staff recommended some adjustments to the 3.01 report, and the Commission ordered BellSouth to reduce its rates by $56.285 million.

On appeal this court held that the Commission did not have the power to adjust the figures in the 3.01 report, and we remanded the case "to the Tennessee Regulatory Authority with directions to approve BellSouth's application for a price regulation plan." 972 S.W.2d at 682. BellSouth filed a petition to rehear seeking an order from this court that the price regulation plan became effective on March 1, 1995. We declined the invitation and left it up to the agency "to carry out its task in a manner consistent with its statutory authority." 972 S.W.2d at 683.

On remand BellSouth contended that this court's opinion required an immediate order approving a price regulation plan and moved for a plan effective as of October 1, 1995. BellSouth conceded that the freeze on basic rates and call waiting services should be extended to August 1, 2002 and that the indexing for annual adjustments for basic and non-basic rates should begin on August 1, 1998. The Consumer Advocate Division

moved to start over. The Regulatory Authority approved BellSouth's motion with one exception. The annual adjustments for basic and non-basic services will be calculated from December 1, 1998.

II.

The Scope of the Remand

The Consumer Advocate Division asserts that the Regulatory Authority erred in concluding that this court's opinion required it to take the action it took. A remand may take one of several forms. It may dictate the course of further proceedings, *Hoover v. Metropolitan Board of Zoning Appeals,* 955 S.W.2d 52 (Tenn.Ct.App.1997), it may be made for a specific purpose. *Mathis v. Campbell,* 22 Tenn.App. 40, 117 S.W.2d 764 (Tenn.Ct.App.1938), or it may be open and general. Here, however, we agree that this court's remand did not require the Authority to approve, without qualification or further inquiry, BellSouth's 1995 application. On the petition to rehear in *Greer,* we made the following observations with respect to BellSouth's request for a holding that its price regulation plan became effective on March 1, 1996:

> ***2** Our October 1, 1997 opinion focused on the procedure employed by the Tennessee Public Service Commission to consider and act on BellSouth's application for a price regulation plan. Rather than focusing on the substance or merits of the Commission's decision, we held that the procedure the Commission followed did not comply with Tenn.Code Ann. § 65-5-209. Accordingly, we vacated the Commission's orders and remanded the case to its successor for further proceedings consistent with the requirements of Tenn.Code Ann. § 65-5-209.

The doctrine of separation of powers counsels the courts to avoid requiring an administrative agency to take a particular action except in the most extraordinary circumstances. We should decline, for constitutional and practical reasons, to shoulder an agency's responsibilities. Thus, the goal of a remand in cases of this sort should generally be to require the agency to carry out its task in a manner consistent with its statutory authority. *See Hoover, Inc. v. Metropolitan Bd. Of Zoning Appeals,* 955 S.W.2d 52, 55 (Tenn.Ct.App.1997).

Throughout these proceedings, BellSouth consistently asserted that the procedure followed by the Commission was not authorized by Tenn.Code Ann. § 65-5-209 and requested the courts to require the regulators to make their decisions in accordance with Tenn.Code Ann. § 65-5-209. Our October 1, 1997 opinion settles the dispute concerning what Tenn.Code Ann. § 65-5-209 requires. Now it falls upon the Tennessee Regulatory Authority to consider BellSouth's application for a price regulation plan in accordance with Tenn.Code Ann. § 65-5-209.

The key to the scope of the remand is contained in the last quoted paragraph. We resolved one question about price regulation. We left it to the Authority to consider BellSouth's application in accordance with Tenn.Code Ann. § 65-5-209 and to "carry out its task in a manner consistent with its statutory authority." Therefore, the Authority was not under a mandate to take any particular action. It could not, however, adjust the actual results on BellSouth's 3.01 report.

III.

The Regulatory Authority's Decision

Our conclusion that the Authority was not compelled to take the action it took opens up the question of whether it was compelled to take some other action. The Consumer Advocate Division attacks the Agency's action on several fronts.

A. The 3.01 Audit

The Consumer Advocate Division asserts that the Authority did not have the assurance that BellSouth's March 1995 3.01 report was in compliance with generally accepted accounting principles. *See* Tenn.Code Ann. § 65-5-209(j). The Agency staff gave a "negative" assurance, meaning that it did not make that determination itself but relied on the company's internal controls and independent audit-

ors for the assurance.

After initially making the same arguments in the prior proceeding, the Consumer Advocate Division dropped its objection and did not pursue it on appeal-despite a finding by the PSC that the 3.01 report accurately reflected BellSouth's earned rate of return according to generally accepted accounting principles. By failing to challenge that finding on appeal, the Consumer Advocate Division waived any objection to it, *Lewter v. O'Connor Management, Inc.,* 886 S.W.2d 253 (Tenn.Ct.App.1994), and it is now the law of the case. *See Ladd v. Honda Motor Co.,* 939 S.W.2d 83 (Tenn.Ct.App.1996).

***3** In addition, in the prior appeal the Consumer Advocate Division actually defended the PSC's action, because it resulted in a sizeable reduction in rates. Having taken that position, the Division must confront the rule that a litigant is required to act consistently throughout the litigation. *Fidelity-Phenix Fire Ins. Co. v. Jackson,* 181 Tenn. 453, 181 S.W.2d 625 (Tenn.1944). Other courts have talked in terms of judicial estoppel. *See Bubis v. Blackman,* 58 Tenn.App. 619, 435 S.W.2d 492 (Tenn.Ct.App.1968); *Stamper v. Venable,* 117 Tenn. 557, 97 S.W. 812 (Tenn.1906). Thus, we conclude that the objections to the 3.01 audit cannot be pursued on this appeal.

B. Federal Preemption

The Consumer Advocate Division devotes a lengthy part of its appellate brief to an argument that the preemptive effect of the Federal Telecommunications Act of 1966 (which took pay phones out of regulated operations) was a compelling reason to reopen the case below. In the prior appeal AT & T argued that federal preemption was a reason to deny price regulation and remand the case to the Regulatory Authority for consideration of that issue. We rejected AT & T's argument then, in part because some of the issues were already before the Authority in separate proceedings involving AT & T and BellSouth. We said, "This type of proceeding, and others like it, provide the parties with an appropriate forum to air out and resolve more clearly defined issues concerning the possible preemptive effect of the specific provisions of the Telecommunications Act of 1966...."

In this appeal BellSouth points out that the changes in payphone regulation are already the subject of a separate proceeding pending before the Authority. We think our decision in *Greer* applies with equal force to this issue. We are not convinced that a federal law prohibiting pay phones from being subsidized by the company's rate-payers affects BellSouth's price regulation plan, but the pending proceeding can determine if BellSouth's rates should be adjusted to reflect the changes in the law.

C. Retroactive Ratemaking

The Consumer Advocate Division asserts that the Authority engaged in retroactive ratemaking by approving BellSouth's price regulation plan effective October 1, 1995. *See South Central Bell v. Tennessee Public Service Commission,* 675 S.W.2d 718 (Tenn.Ct.App.1984). We disagree.

The Regulatory Authority's order did not attempt to change rates retroactively. The rates had been in effect for some time before the June 6, 1995 application for price regulation. The whole thrust of the Consumer Advocate Division's four year effort has been to convene a contested case hearing for the purpose of setting new rates. The only rate changes under the Authority's December 1998 order will be prospective. Annual rate adjustments for nonbasic services are to be calculated from December 1, 1998, and there can be no increase in the rates for basic services or call waiting until December 1, 2002. By making the order prospective only, the Authority avoided the charge that future ratepayers would "pay for past use," which is the essence of retroactive ratemaking. *Porter v. South Carolina Public Service Comm'n,* 328 S.C. 222, 493 S.E.2d 92 (S.C.1997). The order also eliminated BellSouth's right to seek an increase in nonbasic services in 1996, 1997, and 1998, which it would have had if the Public Service Commission had acted lawfully in 1995. As we view it, the Au-

thority's order places BellSouth as nearly as possible in the position they would have been in except for the Commission's error. That was the goal of the Authority on remand. *See Hoover, Inc. v. Metropolitan Board of Zoning Appeals,* 955 S.W.2d 52 (Tenn.App.1997).

IV.

*4 "The sole concern of the courts, at each stage of appellate review, it to determine whether the [Regulatory Authority's] action on the matters raised by the application meet the requirements of the law." *CF Industries v. Tenn. Public Service Commission,* 599 S.W.2d 536 at 544 (Tenn.1980). We are satisfied that the Authority acted within the scope of its powers.

We affirm the Authority's order and remand the cause to the Authority for any further proceedings that are necessary. Tax the costs on appeal to the Consumer Advocate Division.

KOCH and CAIN, JJ., concur.

Tenn. Ct. App.,2000.
Consumer Advocate Div. ex rel. Tennessee Consumers v. Tennessee Regulatory Authority
Not Reported in S.W.3d, 2000 WL 13794 (Tenn.Ct.App.)

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Slip Copy, 2012 WL 1964593 (Tenn.Ct.App.)
(Cite as: 2012 WL 1964593 (Tenn.Ct.App.))

Only the Westlaw citation is currently available.

SEE COURT OF APPEALS RULES 11 AND 12

Court of Appeals of Tennessee.
CONSUMER ADVOCATE & PROTECTION DIVISION OF the OFFICE OF the ATTORNEY GENERAL OF TENNESSEE
v.
TENNESSEE REGULATORY AUTHORITY.

No. M2011–00028–COA–R12–CV.
Sept. 27, 2011 Session.
May 30, 2012.

Background: Consumer Advocate and Protection Division of the Office of Tennessee's Attorney General sought review of an order of the Tennessee Regulatory Authority (TRA), challenging the TRA's authority to allow a natural gas utility to recover attorney fees that were incurred in an asset management docket proceeding before the TRA, and the TRA's authority to order that the attorney fees be recovered from asset management funds.

Holdings: The Court of Appeals, Holly M. Kirby, J., held that:
(1) TRA had the authority to order that such litigation fees be recovered as any other reasonable and prudent operating expense of the utility, and
(2) TRA acted within its authority in ordering that the fees be paid out of asset management funds.

Affirmed.

West Headnotes

[1] Gas 190 ⇐14.3(3)

190 Gas
190k14 Charges
190k14.3 Administrative Regulation
190k14.3(3) k. Proceedings in General. Most Cited Cases

Natural gas utility's asset management docket proceeding that was before the Tennessee Regulatory Authority (TRA) was not a rate case and, thus, TRA could not award litigation expenses, including attorney fees, to utility premised on the case's purported rate case status, where TRA evaluated utility's asset management practices to ensure that consumers were not being exploited and rates were neither proposed nor set.

[2] Gas 190 ⇐14.3(3)

190 Gas
190k14 Charges
190k14.3 Administrative Regulation
190k14.3(3) k. Proceedings in General. Most Cited Cases

Tennessee Regulatory Authority (TRA) was not authorized to award litigation expenses, including attorney fees, to natural gas utility in an asset management docket proceeding on the theory that the docket stemmed from a rate case, even though the Consumer Advocate originally raised asset management issues in a rate case, where asset management issues were not decided in the rate case docket, the estimated litigation expenses incorporated into the rate that was set in the rate case did not include fees for litigation of asset management issues, and asset management issues were transferred and resolved in their own separate docket, apart from the setting of base rates.

[3] Gas 190 ⇐14.3(3)

190 Gas
190k14 Charges
190k14.3 Administrative Regulation
190k14.3(3) k. Proceedings in General. Most Cited Cases

Transfer of the question of natural gas utility's litigation expenses for asset management docket proceeding before the Tennessee Regulatory Authority (TRA) to the second of two rate cases, in

part so that the litigation expenses could be decided "in the context of a rate case," did not transform the asset management docket into a rate case so that TRA could award litigation expenses, including attorney fees, to utility premised on the case's purported rate case status, where the issue of whether utility could recover asset management docket litigation expenses was presented and decided separately from the rate case issues in that docket.

[4] Gas 190 ⚿14.3(3)

190 Gas
190k14 Charges
190k14.3 Administrative Regulation
190k14.3(3) k. Proceedings in General. Most Cited Cases

Tennessee Regulatory Authority (TRA) had the authority to permit natural gas utility to recover from its customers the reasonable and prudent litigation expenses incurred in the asset management docket, a proceeding that was a non-rate case, given TRA's plenary authority to regulate utilities and the absence of a statute, regulation, or other authority prohibiting the TRA's actions.

[5] Gas 190 ⚿14.3(3)

190 Gas
190k14 Charges
190k14.3 Administrative Regulation
190k14.3(3) k. Proceedings in General. Most Cited Cases

Tennessee Regulatory Authority's (TRA) awarding natural gas utility its litigation expenses, including attorney fees, incurred in an asset management docket proceeding involving an evaluation of utility's asset management practices to ensure that consumers were not being exploited did not violate that American Rule that each party should bear his own legal costs absent a contrary contractual or statutory provision, where TRA did not order consumer groups to pay anything to utility, but rather, permitted the utility to recover from its customers the utility's reasonable and prudent litigation expenses.

[6] Gas 190 ⚿14.3(3)

190 Gas
190k14 Charges
190k14.3 Administrative Regulation
190k14.3(3) k. Proceedings in General. Most Cited Cases

Tennessee Regulatory Authority (TRA) did not engage in impermissible retroactive ratemaking when it awarded natural gas utility its litigation expenses, including attorney fees, incurred in an asset management docket proceeding involving an evaluation of utility's asset management practices to ensure that consumers were not being exploited, even though the Consumer Advocate originally raised asset management issues in a since-closed rate case; TRA's authority to allow utility to recover its asset management docket litigation expenses was not based on the fact that it "stemmed" from a rate case, but rather, the TRA had the authority to permit utility to recover as an extraordinary operating expense the litigation expenses incurred in the asset management docket.

[7] Gas 190 ⚿14.3(3)

190 Gas
190k14 Charges
190k14.3 Administrative Regulation
190k14.3(3) k. Proceedings in General. Most Cited Cases

Tennessee Regulatory Authority (TRA) had authority, by virtue of its plenary power to set rates and govern and regulate utilities, to order that the asset management docket litigation expenses incurred by natural gas utility, including attorney fees, be paid from asset management funds.

An Appeal from the Tennessee Regulatory Authority, No. 09–00183.Robert E. Cooper, Jr., Attorney General & Reporter; Joseph F. Whalen, Associate

Solicitor General; and Vance L. Broemel, Assistant Attorney General, for the Petitioner/Appellant Consumer Advocate & Protection Division of the Office of the Attorney General of Tennessee.

J. Richard Collier and Kelly Cashman–Grams for the Respondent/Appellee Tennessee Regulatory Authority.

J.W. Luna and Jennifer L. Brundige, Nashville, Tennessee, for the Respondent/Appellee Chattanooga Gas Company.

Henry Walker, Nashville, Tennessee, for the Petitioner/Appellee Chattanooga Regional Manufacturer's Association.

HOLLY M. KIRBY, J., delivered the opinion of the Court, in which DAVID R. FARMER, J., and J. STEVEN STAFFORD, J., joined.

OPINION

HOLLY M. KIRBY, J.

***1** This is an appeal from an order of the Tennessee Regulatory Authority ("TRA"). The appeal was filed by the Consumer Advocate and Protection Division of the Office of Tennessee's Attorney General. It challenges the TRA's authority to allow a gas company to recover attorney fees that were incurred in a proceeding before the TRA that did not involve rate-making, and the TRA's authority to order that the attorney fees be recovered from asset management funds. We conclude that the TRA has the authority to order that such litigation fees be recovered as any other reasonable and prudent operating expense of the utility, and that the TRA acted within its authority in ordering that the fees be paid out of asset management funds. The TRA's decision, therefore, is affirmed.

Before we outline the facts and proceedings at issue in this appeal, a brief overview of the parties, terminology, and regulatory framework is helpful to an understanding of the issues on appeal.

BACKGROUND

Respondent/Appellee Chattanooga Gas Company ("the Gas Company") is a corporation engaged in the business of transporting, distributing, and selling natural gas in Chattanooga and Cleveland, Tennessee, and in other portions of Hamilton and Bradley Counties as well. Although the Gas Company is a for-profit corporation, it is also a public utility, and its operations are subject to the jurisdiction of Respondent/Appellee Tennessee Regulatory Authority ("TRA"). *See* Tenn.Code Ann. § 65–4–101, *et seq.*

Utility customers in the areas served by the Gas Company pay it to provide them with natural gas via the customers' monthly bills. The Gas Company's rates and charges must be set forth in tariffs filed by the Gas Company with the TRA, and the Gas Company can charge the customer only the rates and charges that are set forth in a filed and effective tariff. *See* Tenn.Code Ann. § 65–5–102; Tenn. Comp. R. & Regs. 1220–4–1–.03. The tariff in this case is a multipage loose-leaf document "so that changes [can] be made by reprinting and inserting a single leaf" when the tariff is revised. *See* Tenn. Comp. R. & Regs. 1220–1–4–.02. Thus, a customer's monthly bill reflects the sum of all of the charges that the company is entitled to charge, as set forth in the tariff.

The two main components of the Gas Company's monthly bill charges are (1) the *cost of distributing the gas* to the consumer, and (2) the *cost of the gas* commodity itself, which includes the cost of storing and transporting that commodity to the Gas Company's distribution system for available use. The charges for these two components are set forth in the tariff and regulated by the TRA. However, each component is governed by a different set of rules. This is explained in more detail below.

The Distribution of Gas—Base Rates

By statute, the Gas Company is permitted to charge a reasonable base rate for the service of distributing natural gas to the consumer. Tennessee

Code Annotated § 65–5–101 gives the TRA the authority "to fix just and reasonable individual rates, joint rates, tolls, fares, charges or schedules thereof, as well as commutation, mileage, and other special rates" charged by any public utility. The utility is permitted to set base rates that allow it to recover its operating expenses and earn a profit from the consumer from the operation of its business; in overseeing these base rates, the TRA is required to balance the interests of the utility with the interests of Tennessee consumers. *See Tenn. Am. Water Co. v. Tenn. Reg. Auth.,* No. M2009–00553–COA–R12–CV, 2011 WL 334678, at *15 (Tenn.Ct.App. Jan.28, 2011). On one hand, the rate approved by the TRA must provide the utility the opportunity to earn a just and reasonable return on its investment; on the other hand the rate must not be exorbitant, so as to avoid the exploitation of consumers. *See Bluefield Water Works & Improvement Co. v. Public Serv. Comm'n of the State of West Va.,* 262 U.S. 679, 690, 43 S.Ct. 675, 67 L.Ed. 1176 (1923). "A rate need only fall within the 'zone of reasonableness' ... that takes into consideration the interests of both the consumer and the utility." *Tenn. Cable Television Ass'n. v. Tenn. Pub. Serv. Comm'n,* 844 S.W.2d 151, 159 (Tenn.Ct.App.1992).

***2** If the public utility wants to increase its base rates, because of increased expenses, decreased revenues, or any other reason, it must file a revised tariff and a petition with the TRA to revise the existing rates at least thirty days before the effective date of the new rates. Tenn. Comp. R. & Regs. 1220–4–1–.03 to .06; *see* Tenn.Code Ann. § 65–5–103.[FN1] The TRA then has several options. It can simply allow the revised rate to go into effect by taking no action. In the alternative, the TRA has the authority to suspend the rate increase pending an investigation into whether the rate increase is just and reasonable. *See* Tenn.Code Ann. § 65–5–103. The TRA also has the option to convene a contested case and allow interested parties to intervene in the matter to oppose the rates. If the TRA conducts an investigation or contested hearing and then authorizes a rate revision other than the one requested by the public utility, the utility must file a revised tariff that sets out the rates authorized by TRA. Only after the revised tariff becomes effective can the public utility charge consumers the increased rates. The revised tariff remains in effect until it is modified. *See* Tenn.Code Ann. § 65–5–103; Tenn. Comp. R. & Regs. 1220–4–1–.03 to .06; *see also City of Chattanooga v. Tenn. Reg. Auth.,* No. M2008–01733–COA–R12–CV, 2010 WL 2867128, at *1 (Tenn.Ct.App. July 21, 2010). In utility regulatory parlance, a proceeding before the TRA that involves the setting of base rates is commonly referred to as a "rate case."

> FN1. A public utility is prohibited from raising the rates it charges consumers unless it files a petition with the TRA. *See City of Chattanooga v. Tenn. Reg. Auth.,* No. M2008–01733–COA–R12–CV, 2010 WL 2867128, at *1 (Tenn.Ct.App. July 21, 2010) (citing Tenn.Code Ann. § 65–5–103).

In a rate case, the TRA will generally consider the utility's revenues and operating expenses for a given test period. It then uses that information to predict the rate of return that the revised rate structure will produce in the reasonably foreseeable future. To evaluate the requested rate, the TRA takes into consideration the estimated effect of predicted revenues, expenses, and investments. The attorney fees that the public utility reasonably anticipates will be incurred in the rate case itself are called "litigation expenses" or "Rate Case Expenses."[FN2] These litigation expenses are recoverable as any other business expense in the rate case; that is, the expenses are built into the revised rates. In this way, the TRA permits the utility to recover from consumers the reasonable and prudent litigation expenses incurred in the regulatory proceeding through the setting of the utility's rates going forward. *See Tenn. Am. Water Co. v. Tenn. Reg. Auth.,* No. M2009–00553–COA–R12–CV, 2011 WL 334678, at *26–27 (Tenn.Ct.App. Jan.28, 2011).

The parties involved in this appeal do not challenge the authority of the TRA to permit the utility to recover litigation expenses in this manner in a rate case.[FN3]

FN2. As used in this Opinion, the phrase "litigation expenses" includes attorney fees unless otherwise indicated.

FN3. As stated by the Consumer Advocate in its appellate brief: "In general, litigation costs in rate cases are treated similarly to a number of other expenses for which a utility can seek recovery in a rate case, including such items as wages and salaries, pensions, depreciation, and administrative costs." Appellant's Brief at pp. 14–15 (citing *Tenn. Am. Water Co.*, 2011 WL 334678, at *26–27).

Cost of Gas

The other main component of the Gas Company's monthly charges is the cost of gas. The Gas Company must purchase gas and have it delivered to its own distribution system at the level needed to meet the full natural gas supply needs of the consumers.[FN4] *See* Tenn.Code Ann. § 65–4–114 & 115. Generally, the cost of gas is charged to consumers on a pass-through basis. This means that the utility does not earn a profit from the cost of gas; the consumer pays the wholesale price, or what the utility paid for the gas.[FN5] The cost of gas is calculated by using the mechanism set forth in the Purchased Gas Adjustment ("PGA") Rules, found in Tenn. Comp. R. & Regs. 1220–4–7 of the Rules of the Tennessee Regulatory Authority .[FN6] Under the PGA Rules, the Gas Company is directed to adjust its charges to recover the cost of gas (which is not included in the utility's rate base) from consumers through their monthly bills. The PGA Rules seek to ensure that the Gas Company neither over-collects nor under-collects gas costs from consumers.[FN7] *See* PGA Rule 1220–4–7–.02(1) & 1220–4–7–.03(1)(a)5(iv).

FN4. The Gas Company has about 62,000 "firm customers." As defined in the Gas Company's tariff, "firm customers" are customers for whom the Gas Company has a firm obligation to supply gas that is not ordinarily subject to interruption or curtailment.

FN5. This is in contrast to the cost of distributing the gas. As noted above, the Gas Company is permitted to earn a profit in the rate charged to the consumer for the cost of distributing the gas.

FN6. The Tenn. Comp. R. & Regs. 1220–4–7 and the subsections therein will be cited as "PGA Rule" in this Opinion.

FN7. As stated in the regulations, "The[ ] Purchased Gas Adjustment (PGA) Rules are intended to permit the company to recover, in timely fashion, the total cost of gas purchased for delivery to its customers and to assure that the Company does not over-collect or under-collect Gas Costs from its customers." PGA Rule 1220–4–7–.02(1).

***3** The PGA mechanism for calculating the cost of gas is quite complicated; it involves intricate formulas that take into consideration fixed gas costs, variable costs, and related charges. The Purchased Gas Adjustment itself is comprised of three major components: (1) the Gas Charge Adjustment, (2) the Refund Adjustment, and (3) the Actual Cost Adjustment. The utility is required to file a variety of PGA tariff sheets related to the PGA calculations.[FN8]

FN8. We need not go into detail about the various PGA tariff sheets required to be filed with the TRA. Suffice it to say that the PGA tariff sheets are filed with the TRA, and the TRA must approve any changes in these tariff sheets.

Before a utility is permitted to alter the PGA,

the utility must file the proposed tariff changes with the TRA at least thirty days before the effective date. *See* PGA Rule 1220–4–7–.02(3). If the TRA does nothing, the revised rates go into effect after expiration of the thirty-day period. The TRA may instead choose to suspend the proposed changes and set the matter for a hearing. The PGA Rules recognize that, in some instances, thirty-days' notice as to the cost of gas is not feasible, such as when the Gas Company receives less than thirty days' notice from its supplier of an increase in price. In such instances, the TRA "may permit the Company to place rates into effect with shorter advance notice, upon good cause shown." PGA Rule 1220–4–7–.02(3).

At least once a year, the utility must file a non-binding gas purchase plan with the TRA. As provided under the PGA Rules, the TRA Staff audits the annual report and filing. *See* PGA Rule 1220–4–7–.05(1). If the TRA does not order a hearing within ninety days of the filing, the public utility's gas purchasing practices are deemed prudent. *See* PGA Rule 1220–4–7–.05(2).

Asset Management Practices

The monthly charges to the Gas Company's customers are also affected by the Company's "asset management" practices, that is, its practices related to gas purchases. The public utility's asset management practices are the method by which it ensures that it will have sufficient natural gas supply available for the consumers.

The Gas Company outsources certain of its asset management tasks to AGL Resources/AGL Services Company ("AGL Resources"), a natural gas distribution company.[FN9] AGL Resources personnel, working exclusively for the Gas Company, determine the level of natural gas that the Gas Company will purchase to fill the needs of its customers. Once the gas is purchased, the Gas Company sells or assigns its rights to some of its pipeline capacity assets, *i.e.* purchased gas, to an asset manager for a fee. The asset manager is then responsible for managing the purchased gas supply so as to ensure that the Gas Company's customers have an adequate amount of gas when they need it. If it is determined that some of the pipeline capacity assets that have been purchased will not be needed to meet the needs of the Gas Company's customers, the asset manager can market the excess assets to other jurisdictions.

> FN9. The Gas Company is a subsidiary of AGL Resources. The Gas Company's functions of load forecasting, pipeline transportation capacity, storage service levels, peaking capability requirements, daily supply resource management, system monitoring, and asset manager compliance are all performed by AGL Resources employees, who work exclusively for the Gas Company.

In this case, the Gas Company entered into an asset management agreement with a company affiliated with the Gas Company, asset manager Sequent Energy Management ("Sequent"). The Gas Company selected Sequent as its asset manager through a competitive Request for Proposal ("RFP") process, as required by the Gas Company's tariff. Under the asset management agreement, Sequent was responsible for marketing and selling the Gas Company's excess assets. The Agreement provides that the profit earned from the non-jurisdictional sales of such excess assets would be shared equally (50/50) between Sequent and the Gas Company. The Gas Company would then, in turn, pass its share of the profit from the asset sales directly to its customers. The Gas Company's affiliate, Sequent, keeps its share of any profits. The asset management agreement between the Gas Company and Sequent required Sequent to pay a minimum annual fee to the Gas Company, regardless of whether any gains were earned from the sale of assets. The costs associated with Sequent's performance of its duties as the Gas Company's asset manager were to be deducted from Sequent's portion of the profits from the asset sales.

*4 Through the Gas Company's asset manage-

ment practices, it has been able to return some of this profit from the sale of excess assets to consumers. For example, over a thirty-nine month period from 2005 to 2008, Gas Company customers received approximately $7.9 million from the non-jurisdictional sale of its gas supply and capacity assets.

Gas Company customers recover their share of the profits from non-jurisdictional asset sales through the Interruptible Margin Credit Rider ("IMCR"), which is included in the Gas Company's tariff at "Gas Tariff, TRA No. 1, Tenth Revised Sheet No. 48." The IMCR provision included in the tariff is not a component of the PGA Rules; rather, it is a tariff provision unique to the Gas Company. The IMCR provision states that it is "intended to authorize the Company to recover not more than ninety percent (90%) of the gross profit margin losses," and "to authorize the Company to recover not more than fifty percent (50%) of the gross profit margin that results from transactions with non-jurisdictional Customers ... should such transactions be made by the Company."

The Gas Company is required to file with the TRA an annual report of the negotiated rate gross profit margin losses and the gross profit margin from non-jurisdictional transactions.[FN10] The IMCR annual report also includes the calculation of the IMCR adjustment factor to be applied to customers' bills. The IMCR factor is a separate billing factor, either a credit or surcharge as applicable. The entire IMCR report, including the accounting for the Gas Company's asset management funds and the application of the IMCR factor to the bills of Gas Company customers, is subject to an annual audit by the TRA Staff.

FN10. This annual filing is separate and distinct from the annual filing required by PGA Rule 1220–4–7–.03(2).

ADMINISTRATIVE PROCEEDINGS BELOW

Rate Case 1—Docket No. 06–00175

On June 30, 2006, the Gas Company filed a petition with the TRA. Among other things, the petition sought to increase the Gas Company's base rate and implement a new rate design proposal.[FN11] As required, the Gas Company filed the revised tariff with its petition and requested that the new rate be effective as of January 1, 2007. In the same time period, the Gas Company filed several other tariffs, all containing the effective date of July 31, 2006. To consider these matters, the TRA convened a contested case proceeding under Docket No. 06–00175. In this Opinion, Docket No. 06–00175 is referred to as "Rate Case 1."

FN11. The Gas Company requested that the TRA approve the implementation of a comprehensive rate design proposal, which included an Energy Conservation Plan and a Conservation and Usage Adjustment.

In July 2006, on behalf of local consumers, the Petitioner/Appellant Consumer Advocate and Protection Division of the Office of the Attorney General of Tennessee ("Consumer Advocate")[FN12] and Respondent/Appellee Chattanooga Regional Manufacturer's Association (individually "the Manufacturer's Association") (collectively "Consumer Groups"),[FN13] on behalf of local consumers, filed petitions to intervene in Rate Case 1. The intervenor petitions claimed that the increase in revenue and other changes sought by the Gas Company were not fair, just, or reasonable, and were not in the best interest of the consumer. On July 27, 2006, the TRA entered an order suspending the tariffs, granting the Consumer Groups' motions to intervene, and establishing a schedule for the proceedings. In addition, the TRA bifurcated the proceedings into two phases: revenue requirement (Phase I) and rate design (Phase II).

FN12. The Consumer Advocate is a division of the Office of the Attorney General & Reporter which represents the interests of Tennessee consumers of public utilities. *See* Tenn.Code Ann. §§ 65–4–118(c), 65–5–110(b) (2004).

FN13. The Manufacturer's Association describes itself as a one-hundred-year-old trade association representing over 250 manufacturers and other businesses supporting, servicing, and associated with the manufacturing sector. Many are customers of the Gas Company.

*5 During the proceedings, the Consumer Groups raised concerns related to the asset management arrangement between the Gas Company and its affiliate, Sequent. The Consumer Advocate wanted to examine Sequent's gas purchase practices and had concerns about whether Sequent and the Gas Company were purchasing the correct amount of gas under their gas supply plan. Essentially, the Consumer Groups alleged that the Gas Company was oversubscribing its capacity assets, that is, purposefully buying too much gas to help its affiliate Sequent make profits on the sale of the excess, to the detriment of consumers. Those concerns did not fit neatly into the characterization of either Phase I or Phase II, but the TRA made a decision to move the issues to Phase II of the proceedings.

On November 20, 2006, the Gas Company and the Consumer Groups filed with the TRA a "Proposed Settlement Agreement" to resolve the Phase I issues. At a regularly held TRA Conference held on December 5, 2006, the Settlement Agreement was unanimously approved by the TRA. This concluded Phase I of the TRA proceedings.

On May 8, 2007, the Gas Company filed a request with TRA to close Phase II of the proceedings, because the issues that the parties proposed to address in Phase II—energy conservation, asset management, and capacity release—were being addressed in an existing docket, Docket No. 06–00298.[FN14] To facilitate its request to close Phase II, the Gas Company stated that it would withdraw the conservation initiatives it had proposed as part of its original TRA petition. The Consumer Groups both objected to the closing of Phase II and expressed concern regarding their opportunity to be heard on the asset management and capacity release issues. Ultimately, however, the Consumer Groups agreed that Docket No. 06–00298 would provide an acceptable forum for litigation of those issues.

FN14. Some evidence in the record suggests that on February 23, 2007, the Phase II proceedings were suspended pending a decision that was already before the TRA in a rate case involving Atmos Energy, Docket No. 05–00258, regarding the issue of what was the appropriate forum for the Consumer Advocate to litigate gas supply costs and asset management practices. The Gas Company filed this motion to close Phase II in Rate Case 1 because, based on the suspension of the proceedings, there was no activity in the docket.

Accordingly, at a regularly scheduled Authority Conference on July 9, 2007, the TRA voted to approve the Gas Company's request to close Phase II, and the case was closed by TRA order entered on December 17, 2007. Because the audit performed in Docket No. 06–00298 had been completed by the time the TRA order was entered, and the introduction of new issues into that case would likely have created unnecessary delay in the final resolution of the audit, the TRA decided to form a separate docket to consider the asset management and capacity release issues raised by the Consumer Groups.[FN15] This separate docket is discussed below.

FN15. The record indicates that the parties agreed to the transfer of the asset management issues into a separate docket to avoid complications that would arise if a final order were not entered in the existing docket within six months after the filing of the petition. *See* Tenn.Code Ann. § 65–5–103(a), (b).

The Asset Management Docket—Docket No. 07–00224

Accordingly, the TRA opened a new contested

case under Docket No. 07–00224 in order to conduct an "evaluation of [the Gas Company's] gas purchases and related sharing incentives." The Consumer Groups were allowed to intervene in this docket and to participate in the proceedings.[FN16] On January 15, 2008, the TRA issued an order convening a contested case. This new docket is referred to herein as "the Asset Management Docket."

> FN16. The Manufacturer's Association indicated that it intended to intervene in this docket, but it apparently never filed a petition to intervene. Nevertheless, Counsel for the Manufacturer's Association regularly participated in the proceedings.

***6** Because the asset management issues were removed from Rate Case 1, and the litigation expenses involved in the new docket would not be factored into the setting of rates in Rate Case 1,[FN17] the Gas Company sought to recover those litigation expenses in the context of the Asset Management Docket. To this end, on February 28, 2008, at the beginning of the proceedings in the Asset Management Docket, the Gas Company filed a motion to accumulate and defer its litigation costs for financial accounting and regulatory purposes so that, in the end, it would be able to recover those costs from consumers in the future if the TRA determined that the litigation expenses were recoverable. Additionally, the Gas Company sought "as an ultimate issue in this proceeding to recover the costs incurred in this contested case proceeding from the ratepayers through the Purchased Gas Adjustment Rule ('PGA'), Chapter 1220–4–7." The Gas Company reasoned: "As all claims to be litigated in this docket relate to gas and capacity related costs includible in [the Gas Company's] PGA, it is proper for [the Gas Company] to recover the costs associated with the litigation in this contested case proceeding through the PGA."

> FN17. The Gas Company recovered $300,000 in litigation expenses in Rate Case Expenses incurred in in Rate Case 1 through the setting of the base rates.

The TRA granted the Gas Company's request to accumulate and defer the litigation costs, but clarified that "[t]his determination ... does not address the issue of whether [the Gas Company] may recover these costs in the future from ratepayers," and it expressly reserved that issue for a later date. On March 17, 2008, the TRA entered an order setting the issues to be decided in the Asset Management Docket. The order expressly included the issue of whether the Gas Company would be able to recover from ratepayers litigation costs incurred as a result of its participation in the Asset Management Docket.[FN18]

> FN18. The list of issues to be addressed in the Asset Management Docket was the subject of some debate. The Consumer Advocate submitted a revised list of the issues it proposed for resolution in the Asset Management Docket, and the Gas Company filed a response and a motion to dismiss the claims asserted against it by the Consumer Groups. The TRA denied the Gas Company's motion to dismiss and set out its own list of issues to be decided in that docket.

By all accounts, the Asset Management Docket was a "complex, lengthy, and protracted" adversarial proceeding that lasted some two years. It is not necessary for us to recount the details of those proceedings. However, we note that the Asset Management Docket proceedings included a myriad of disputes; the parties participated in four rounds of discovery, and in the course of discovery, the Gas Company was required to respond to over two hundred requests for production propounded by the Consumer Groups. The extensive discovery also resulted in numerous briefings, motions to compel, and status conferences. At one point during the proceedings, the Consumer Advocate compared itself to a prosecutor in a criminal proceeding and claimed that the Gas Company was engaging in defense tactics similar to those of an accused criminal. The Gas Company, on the other hand, described

the Consumer Advocate's discovery requests and overall tactics by using phrases such as "abusive and expensive fishing expedition," or "witch hunt," or "wild goose chase."

On June 22, 2009, prior to the final hearing in the Asset Management case, the Gas Company filed a motion for clarification relating to issues of accumulated and deferred litigation costs. The motion asked for instructions from the TRA on the proper time at which the Gas Company should provide proof concerning the accumulated and deferred legal expenses it incurred in the proceedings, considering the fact that the Gas Company's litigation expenses would extend beyond the final hearing. In the Consumer Advocate's response, it agreed with the Gas Company that the litigation costs may extend beyond the close of the final hearing, and it took the position that the hearing on the merits in the Asset Management case was not the appropriate time to address the issue of the Gas Company's litigation expenses. The Consumer Advocate's response also stated: "In agreeing to take up this issue after the hearing, the Consumer Advocate does not waive its right to contest any aspect of the cost issue, including, but not limited, to amount." On June 29, 2009, during a pre-hearing conference, the TRA Hearing Officer agreed with the parties and directed the Gas Company to file the proof on its litigation costs at the close of the Asset Management case proceeding. The hearing on the merits was scheduled for July 13, 2009.

*7 On July 8, 2009, prior to the scheduled hearing, the parties jointly filed a Proposed Settlement Agreement, resolving all issues in the Asset Management Docket. It included an agreement to permit the Gas Company to recover the legal expenses incurred in the Asset Management docket. The Proposed Settlement Agreement further provided that the Gas Company's litigation expenses "shall be recorded in the Deferred Gas Cost Account and shall be recovered based on the schedule below through the procedures set forth in the PGA Rules, subject to submission of such costs to the Authority, the Authority's determination that such costs were prudently incurred, and subject to a maximum cap in the amount of $500,000."

On July 13, 2009, prior to convening the scheduled hearing on the merits, the TRA considered the parties' Proposed Settlement Agreement. The TRA voted unanimously to deny the Proposed Settlement Agreement, finding that it did not set forth a useful process that could be implemented by the TRA for continuing or future evaluation of the subject matters it addressed. The TRA also found that the proposed settlement was not in the best interest of consumers, the parties, or the TRA. After rejecting the Proposed Settlement Agreement, the TRA commenced the hearing on the merits, and the parties put on their proof.

At the conclusion of the proof, the TRA ordered the parties to file written post-hearing briefs within two weeks of their receipt of the transcript of the Asset Management case hearing. In accordance with the TRA's previous ruling, the proof submitted pertained only to the Gas Company's asset management and capacity release practices; no proof was submitted regarding the litigation expenses incurred by the Gas Company in the Asset Management Docket.

On August 24, 2009, at a regularly scheduled Authority Conference, the TRA found that the Gas Company had subscribed to an appropriate level of mix of storage, peaking, and transportation capacity. It determined that, while the Gas Company's asset mix appeared reasonable at that time, anticipated changes in customer mix, weather, and usage patterns necessitated future periodic review by the TRA of the Gas Company's capacity planning. The TRA also ordered the Gas Company to submit future management RFPs to the TRA for approval prior to placing them out for bid. The TRA concluded by ordering that "a triennial review of capacity planning shall occur beginning in 2012 with the selection of an independent consultant." The TRA allowed the parties a fourteen-day period within which to comment on the TRA's ruling. The

Gas Company and the Consumer Advocate both filed comments.

During its regularly scheduled Authority Conference on September 21, 2009, the TRA panel considered the comments filed by the parties. It voted unanimously to review the Gas Company's capacity planning in 2013, rather than 2012, with any future review to be determined upon the conclusion of the 2013 review. The TRA further determined that the cost of the 2013 review would be borne by the Gas Company, which would then be permitted to recover the cost through the Actual Cost Adjustment ("ACA") account of the PGA Rules.

***8** On October 6, 2009, the Gas Company filed with the TRA detailed proof, including affidavits, of the litigation expenses it incurred in the Asset Management Docket. The Gas Company contended that, over the course of the two plus years of litigation in the Asset Management Docket, it incurred litigation expenses totaling approximately $744,743.81.[FN19] On October 23, 2009, the TRA Hearing Officer entered an order setting the issues and time for filing briefs related to the Gas Company's recovery of its litigation costs. As the Hearing Officer had been informed that the parties had reached a partial agreement on the issue of the Gas Company's recovery of its litigation expense, the Hearing Officer also ordered the parties to file their agreement and provide briefs on: (a) the percentage of the total legal expenses that the Gas Company should be permitted to recover from ratepayers, and (b) the appropriate amortization period for the recovery of approved litigation costs.

> FN19. This figure included the cost of outside attorney fees incurred by two law firms that represented the Gas Company. It did not include the retention of outside experts, because the Gas Company relied on the expertise of its own AGL Resources employees during discovery and at the hearing. It also did not include the expenses incurred in the time and travel costs for those employees.

On October 28, 2009, the Consumer Advocate filed a Stipulation with the TRA, stipulating that it did not contest the accuracy of the total billing amounts for the Gas Company's litigation expenses, that it did not contest that the work had been performed, and that it "agreed that the amount of costs allowed to be recovered shall be recovered through the PGA [Rules]." The parties did not agree about the portion, if any, of those costs the Gas Company should be allowed to recover from consumers, nor did they agree about the amortization period for the recovery of any such costs.

Also on October 28, 2009, the Gas Company and the Consumer Advocate filed briefs with the TRA Panel on the litigation expense issue. The Gas Company asserted that its legal expenses were incurred prudently in defending Gas Company actions that were ultimately found to have been performed in compliance with TRA-approved procedures, and that the expenses were appropriate and reasonable. The Consumer Advocate conceded that the TRA had the authority to award litigation expenses to the Gas Company.[FN20] The Consumer Advocate argued, however, that any such award should be no more than one-half of the Gas Company's expenses in the Asset Management Docket. The Consumer Advocate contended that, if the TRA allowed the Gas Company to recover all of the litigation expenses claimed, "a dangerous precedent would be set for future non-ratemaking dockets." The Consumer Advocate noted that the Gas Company offered no statutory authority for the recovery of such expenses outside of a rate case, but acknowledged that this matter presented a unique situation:

> FN20. At oral argument before the TRA, the Consumer Advocate clarified its position on the subject: "[T]he Consumer Advocate maintains it's in the discretion of the TRA to completely deny Chattanooga Gas' request for cost recovery. Meaning that certainly you can order [that it] recover all their costs, some of their costs, or

none of their costs."

> [G]iven the unique history of this matter, including extensive discovery filed by the Consumer Advocate in an attempt to gather information in this complex Docket of first impression, the Consumer Advocate understands that some recovery of costs may be appropriate under the circumstances.
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> * * *
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> The Consumer Advocate recognizes that this has been a protracted case with extensive discovery and involving complex issues, many of first impression, therefore some award of costs could be justified.

***9** The Consumer Advocate argued that, regardless, any final decision should take into account that the TRA ultimately granted some of the relief requested by the Consumer Advocate by ordering a triennial review of the Gas Company's asset management program. The Consumer Advocate proposed that any recovery of the Gas Company's litigation fees should be spread out over a period of three years to reduce the burden on consumers.

On November 9, 2009, the parties presented oral argument on the litigation expense recovery issue before the regularly scheduled TRA Authority Conference. At the hearing, the Consumer Advocate and the Gas Company agreed that any recovery should be through the PGA mechanism. The TRA took the issue under advisement.

Rate Case 2—Docket No. 09–00183

Around that time, on November 16, 2009, the Gas Company filed another petition with the TRA requesting a rate increase and a modification of its rate design.[FN21] This case was assigned Docket No. 09–00183. Although the TRA panel members are apparently assigned randomly to a given docket, it so happened that the TRA panel assigned to the docket for this petition was comprised of the same three Directors who had been assigned to the Asset Management Docket.[FN22]

> FN21. In that filing, the Gas Company also proposed the implementation of an energy conservation program called EnergySMART and the adoption of an Alignment and Usage Adjustment revenue decoupling mechanism.
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> FN22. The three Directors were TRA Chair Sara Kyle, Director Eddie Roberson, and Director Mary W. Freeman.

At a special TRA Conference on this Gas Company petition, held on November 30, 2009, the TRA panel voted to convene a contested case proceeding, to suspend the tariff for ninety days, and to appoint a Hearing Officer for the purpose of hearing preliminary matters and preparing the matter for a contested hearing before the panel. The Consumer Groups were permitted to intervene in this docket as well for the purpose of opposing the proposed rate increase. This docket is referred to herein as "Rate Case 2."

On December 29, 2009, before the TRA addressed the litigation cost recovery issue pending in the Asset Management Docket, the Manufacturer's Association filed a motion in Rate Case 2 "to Combine the Request of Chattanooga Gas for Reimbursement of Legal Fees in Docket 07–00224 [the Asset Management Docket] with the Request of Chattanooga Gas for a General Rate Increase in Docket No. 09–00183 [Rate Case 2]." The Manufacturer's Association argued that the Gas Company's request for costs should be transferred to Rate Case 2, "because (1) the request is for a specific expense, (2) [the Gas Company's] ratepayers need to have public notice of this increase, as well as, the opportunity to comment, and (3) the TRA does not have the statutory authority to award legal fees outside of a rate case proceeding."

The Consumer Advocate filed a response to the motion to combine. The Consumer Advocate agreed that legal costs could never be awarded by

the TRA in a non-rate case, regardless of the docket in which the costs were incurred. The Consumer Advocate acknowledged that this position was contrary to its earlier concession that the TRA had the discretion to award such expenses. The Consumer Advocate explained that, after reviewing Tennessee authority on the subject, it came to the position that the TRA could not award litigation costs to the Gas Company in this non-rate case. In response, the Gas Company argued that all prudent litigation expenses were recoverable, whether incurred in a rate case or otherwise, and that the Gas Company's legal fees should be categorized as "gas-related costs" and collected from ratepayers under the PGA Rules. Those rules permit amounts paid to a consultant by a local distribution company to be recorded in the Deferred Gas Cost Account and recovered through a PGA filing. *See* PGA Rule 1220–4–7–.05(1)(a)(3).

***10** On January 25, 2010, the parties presented oral argument before the TRA Hearing Officer on the Manufacturer's Association's motion to combine. On February 11, 2010, the Hearing Officer granted the motion and transferred the proceedings related to the Gas Company's request to recover litigation expenses from the Asset Management Docket to Rate Case 2. The Hearing Officer agreed with the Manufacturer's Association and the Consumer Advocate that the prudency of the costs incurred should be considered within a rate case and found that, because Rate Case 2 was ongoing, it was both practical and efficient to combine the Gas Company's request for litigation expenses with the issues in that docket. The Hearing Officer rejected the Gas Company's position and determined that the legal fees requested in the Asset Management Docket were not "gas-related costs" and could not be collected pursuant to the PGA Rules. Rather, he found that utility legal fees and regulatory expenses were ordinarily evaluated in the context of a rate case, and if considered valid and prudent, they could be included in a portion of the overall cost of service for recovery through an increase in the base rate.

Discovery in Rate Case 2 ensued. The Hearing Officer set the matter for a hearing on the merits before the TRA panel in Nashville.

In April 2010, a three-day hearing on the merits was conducted before the TRA panel in Rate Case 2.[FN23] The panel heard testimony from several witnesses on behalf of both the Gas Company and the Consumer Groups.

> FN23. The hearing was conducted on April 12, 13, and 26, 2010.

Regarding the issue of the Asset Management Docket litigation expenses, the Gas Company submitted the testimony of the director of regulatory affairs of AGL Resources, Archie Hickerson ("Mr.Hickerson").[FN24] Mr. Hickerson testified that litigation expenses are normal operating costs of the utility and are routinely included in the regulatory expenses that are incorporated into the cost of service when rates are set. He also asserted that "any cost that the [Gas Company] incurs in the normal [course] of business, they can ask to and recover those costs, and the TRA does have the authority to award the recovery of those costs."

> FN24. Mr. Hickerson testified that he was responsible for the Gas Company's compliance filings with the TRA and developing and maintaining the Gas Company's tariffs.

Mr. Hickerson indicated that, although the Asset Management Docket was not a traditional rate case, the litigation expenses incurred by the Gas Company in that docket were recoverable pursuant to the NARUC[FN25] Uniform System of Accounts and the FERC[FN26] Uniform System of Accounts, adopted by the TRA,[FN27] which provide that "Regulatory Commission Expenses" include "all expenses ... incurred by the utility in connection with formal cases before regulatory commissions or other regulatory bodies." The NARUC and FERC systems also provide that such Regulatory Commission Expenses "shall be charged to account 186, Miscellaneous Deferred Debits, and amortized by

charges to this account." Specifically, the recoverable expense items included "expense of counsel, solicitors, attorneys, ... or defense against petitions or complaints presented to regulatory bodies...." Mr. Hickerson acknowledged, however, that he was not aware of any prior TRA ruling in which the TRA had awarded litigation costs in a non-rate case.

> FN25. National Association of Regulatory Utility Commissioners.
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> FN26. Federal Energy Regulatory Commission.
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> FN27. See Tenn. Comp. R. & Regs. 1220–1–4–.11(1)(c), which provides that the NARUC system of accounting is to be followed by gas companies in making their periodic reports to the TRA.

***11** Mr. Hickerson testified as to the amount of litigation expenses claimed by the Gas Company ($744,743.81), and stated that the Gas Company had filed proper verification for the litigation expenses with the TRA. He also said that the Gas Company proposed to recover these litigation fees via the PGA/ACA mechanism through a temporary rider on the Company's tariff over a period of three years.

The Consumer Advocate submitted the testimony of Terry Buckner ("Mr.Buckner"), who is a Financial Regulatory Analyst in the Office of the Attorney General. Mr. Buckner testified that the issues addressed in the Asset Management Docket, involving the cost of gas and asset management, were not those traditionally addressed in rate cases. He asserted that the TRA does not have authority under Tennessee law to grant a request for recovery of legal fees in a non-rate case, regardless of the docket number in which the decision is made. Mr. Buckner indicated that he relied on the case of *Kingsport Power Company v. Tennessee Public Service Commission,* No. 84–281–II, 1985 WL 1105936 (Tenn.Ct.App. Feb.5, 1985), in reaching this conclusion. Mr. Buckner also addressed the reasonableness of the attorney fees claimed by the Gas Company, opining that the litigation expense sought by the Gas Company was excessive. He pointed out that there had been no evidentiary hearing regarding whether the Gas Company acted prudently in incurring those fees.

In May 2010, the parties submitted post-hearing briefs. On May 24, 2010, the TRA Panel convened at a regularly scheduled Authority Conference to consider the post-hearing briefs. TRA Director Eddie Roberson drafted a recommendation to the panel and submitted it to the panel in the form of a motion. He recommended that the Gas Company be permitted to recover all of the Asset Management Docket litigation expenses requested:

> This has been a most contentious issue between the company and the Consumer Advocate.... I do believe the costs are recoverable since they derived from [a rate case].... It was not the company's or the stockholders' decision whether to spin off the asset manager question into a separate docket. It was the TRA's. The process of [the Asset Management Docket] should cause all of us to consider the cost of litigation, which in the final analysis is a cost to ratepayers, when pursuing regulatory issues. In my mind, the question is not whether the legal fees of the company are recoverable but how they will be recovered.

At the hearing, the other two panel members, TRA Chair Sara Kyle and Director Mary Freeman, agreed with the opinion of Director Roberson.

On November 8, 2010, the TRA issued a lengthy order that resolved the issues related to the Gas Company's petition in Rate Case 2. The TRA order also granted the Gas Company's request to recover the full amount of litigation expenses it incurred in the Asset Management Docket. Furthermore, it permitted the Gas Company to recover those funds from consumers by way of the asset management fund. The TRA explained:

*12 The panel found that [the Gas Company] was required by the Authority to participate in [the Asset Management Docket] and did incur the legal expense in a complex, lengthy and protracted proceeding. Additionally, the panel found that these costs were incurred in litigating the issues stemming from [the Gas Company's] prior rate case docket, [Rate Case 1]. Upon questioning by Director Roberson, Mr. Buckner acknowledged that these legal expenses would have been an allowable rate case expense in [Rate Case 1] if the asset management issue had been litigated within the [Rate Case 1] docket.

Therefore, the panel determined that [the Gas Company] should be allowed full recovery of the legal costs incurred in [the Asset Management Docket]. The panel determined that the most equitable method for the Company to recover these costs would be from asset management funds. Allowing recovery of legal expenses from asset management funds is an appropriate accounting treatment for the non-recurring legal expenses and also provides the Company a more timely recovery of legal expenses it has already paid. The panel determined the recovery of legal expenses should come from the consumers' share of earnings from the asset management fund, rather than through a recurring charge on their monthly bill. Thereafter, the panel voted unanimously that recovery of legal expenses should be from asset management funds.

Thus, the TRA ordered: "The full amount of legal costs from [the Asset Management Docket] shall be recovered and such recovery shall be from asset management funds."

The order also reflected the TRA's decision to allow the Gas Company to recover other expenses from asset management funds. Specifically, the TRA ordered that "[t]he Programmable Thermostat measure and funding of $150,000 for Education and Outreach Programs shall be funded through revenues generated by [the Gas Company's] asset manager and be collected through [the Gas Company's] IMCR tariff." The TRA also ordered the Gas Company to pay $20,000 from asset management funds each year for three years for consumer-oriented research. FN28

FN28. On October 10, 2010, in accordance with the TRA's May 24, 2010 ruling, AGL Resources, on behalf of the Gas Company, filed with the TRA a revised IMCR that included this provision: "The Company shall also recover through this Rider other costs authorized by the Authority." This sentence was added to the IMCR to allow the costs specifically approved by the TRA to be included in the IMCR filing, without having to list each type of cost separately.

The Consumer Advocate now appeals the TRA's decision to permit the Gas Company to recover its litigation expenses incurred in the Asset Management Docket from asset management funds. Although the Manufacturer's Association was aligned with the Consumer Advocate in the proceedings before the TRA, it has changed its alignment on appeal and has filed an appellate brief in support of the Gas Company and the TRA. On appeal, the Manufacturer's Association takes the position that the TRA properly considered the Gas Company's request for Asset Management Docket litigation expenses within the context of a rate case, after proper notice and a hearing, and that the TRA had the authority to grant the Gas Company's request. Thus, the Gas Company, the Manufacturer's Association, and the TRA (collectively "Appellees") have all submitted appellate briefs in support of the TRA's decision.

ISSUES ON APPEAL AND STANDARD OF REVIEW

*13 1. Whether the TRA exceeded its authority when it awarded litigation costs, including attorney fees, for the first time in a case where rates were not being set?

2. Whether a docket to evaluate the Gas Company's asset management practices, in which no

rates were set, was a rate case?

3. Whether the TRA exceeded its authority when it ordered that litigation costs, including attorney fees, should be recovered through a rule governing the cost of gas that does not permit such recovery?

4. Whether the award of litigation costs, including attorney fees, for the asset management docket on the basis that they "stemmed" from a rate case constituted retroactive ratemaking, which is prohibited under Tennessee Law?

One who is aggrieved by a final decision of the TRA must file an appeal with the Middle Division of this Court. Tenn.Code Ann. § 4–5–322(b)(1)(B)(iii) (2011). The standard for appellate review of a decision of the TRA is set forth in Tennessee Code Annotated § 4–5–322(h):

(h) The court may affirm the decision of the agency or remand the case for further proceedings. The court may reverse or modify the decision if the rights of the petitioner have been prejudiced because the administrative findings, inferences, conclusions or decisions are:

(1) In violation of constitutional or statutory provisions;

(2) In excess of the statutory authority of the agency;

(3) Made upon unlawful procedure;

(4) Arbitrary or capricious or characterized by abuse of discretion or clearly unwarranted exercise of discretion; or

(5)(A) Unsupported by evidence that is both substantial and material in the light of the entire record.

(B) 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.

Tenn.Code Ann. § 4–5–322(h). Thus, the review by this Court is for the "very limited purpose of determining whether the [TRA] has acted arbitrarily, or in excess of its jurisdiction, or otherwise unlawfully." *CF Indus. v. Tenn. Pub. Serv. Comm'n,* 599 S.W.2d 536, 540 (Tenn.1980) (quoting *City of Whitwell v. Fowler,* 208 Tenn. 80, 343 S.W.2d 897, 899 (Tenn.1961)).

All of the issues raised by the Consumer Advocate in this appeal involve the question of whether the TRA exceeded its authority or committed other legal error.[FN29] Such issues are reviewed *de novo* on the record, affording no presumption of correctness to the trial court's TRA's decisions. *See Tenn. Am. Water Co.,* 2011 WL 334678, at *15 (citing *Tenn. Envt'l Council, Inc. v. Tenn. Water Quality Control Bd.,* 254 S.W.3d 396, 402 (Tenn.Ct.App.2007)). Issues involving statutory interpretation are also issues of law, which we review *de novo. Kiser v. Wolfe,* 353 S.W.3d 741, 745 (Tenn.2011).

FN29. The Consumer Advocate does not challenge the amount of litigation expenses incurred by the Gas Company or the prudency or reasonableness the amount incurred.

In interpreting the relevant statutes and regulations, we are guided by familiar rules of statutory construction:

***14** The role of this Court in construing statutes is to ascertain and give effect to legislative intent. *Cronin v. Howe,* 906 S.W.2d 910, 912 (Tenn.1995). Whenever possible, legislative intent is to be ascertained from the natural and ordinary meaning of the language used, without forced or subtle construction that would limit or extend the meaning of the language. *Id.* We must avoid strained constructions which would render

portions of the statute inoperative or void. *State v. Turner,* 913 S.W.2d 158, 160 (Tenn.1995). Instead, we must apply a reasonable construction in light of the purposes and objectives of the statutory provision. *Id.*

Consumer Advocate Div. v. Greer, 967 S.W.2d 759, 761 (Tenn.1998) (hereinafter "*Greer* "). Furthermore, "a state agency's interpretation of a statute that the agency is charged to enforce is entitled to great weight in determining legislative intent." *Id.* (citing *Nashville Mobilphone Co., Inc. v. Atkins,* 536 S.W.2d 335, 340 (Tenn.1976)).

ANALYSIS

Authority of the TRA

Our analysis must be rooted in an understanding of the TRA's authority. The TRA is a regulatory agency and, consequently, it may exercise only the authority that is given to it expressly by statute or which arises by necessary implication from an express grant of authority. *BellSouth Adver. & Pub'g Corp. v. Tenn. Reg. Auth.,* 79 S.W.3d 506, 512 (Tenn.2002); *Tenn. Public Serv. Comm'n v. So. Ry. Co.,* 554 S.W.2d 612, 613 (Tenn.1977). The Tennessee legislature's grant of authority to the TRA is broad indeed. By statute, the General Assembly has explicitly granted the TRA "practically plenary authority over the utilities within its jurisdiction." *BellSouth Adver. & Publ'g Corp.,* 79 S.W.3d at 312 (quoting *Tenn. Cable Tele. Ass'n v. Tenn. Pub. Serv. Comm'n,* 844 S.W.2d 151, 159 (Tenn.Ct.App.1992)). The primary statutory grant of authority is found in Tennessee Code Annotated § 65–4–104, which gives the TRA "general supervisory and regulatory power, jurisdiction and control over all public utilities, and also over their property, property rights, facilities, and franchises, so far as may be necessary for the purpose of carrying out the provisions of this chapter." Tenn.Code Ann. § 65–4–104 (2004). Moreover, Tennessee caselaw, in adherence to statutory mandates, directs the courts to give statutes related to the authority of the TRA "a liberal construction;" it cautions that "any doubts as to the existence or extent of a power conferred on the [TRA] ... shall be resolved in favor of the existence of the power, to the end that the [TRA] may effectively govern and control the public utilities placed under its jurisdiction...." *Greer,* 967 S.W.2d at 761–62 (quoting Tenn.Code Ann. § 65–4–106 (Supp.1997)).

Specific to the issues in this case, the TRA has been given broad power "to fix just and reasonable individual rates, joint rates, tolls, fares, charges or schedules thereof, as well as commutation, mileage, and other special rates...." Tenn.Code Ann. § 65–5–101. The authority to fix rates has been delegated totally to the TRA:

> ***15** The General Assembly intended to leave rate-making to the Commission's technical competence and specialized knowledge. *CF Indus. v. Tennessee Pub. Serv. Comm'n,* 599 S.W.2d 536, 540 (Tenn.1980). The only limit it placed on the Commission was that the rates must be "just and reasonable." Tenn.Code Ann. § 65–5–201. The breadth of the Commission's authority has prompted the Tennessee Supreme Court to characterize rate-making as essentially "a value judgment made by the Commission in the exercise of its sound regulatory judgment and discretion." *CF Indus. v. Tennessee Pub. Serv. Comm'n,* 599 S.W.2d at 542.

Tenn. Cable Television Ass'n v. Tenn. Pub. Serv. Comm'n, 844 S.W.2d 151, 159 (Tenn.Ct.App.1992). "The polestar of public utility rate establishment and regulation is the 'just and reasonable' requirement.... There is no statutory nor decisional law that specifies any particular approach that must be followed by the [TRA] ." *CF Indus.,* 599 S.W.2d at 542. The TRA is expected to use its own experience, technical competence, and specialized knowledge in fixing just and reasonable rates, so the TRA's actions in setting rates are not constrained by the record in a given case. *Id.* "Thus, focusing upon the issues, the [TRA] decides that which is just and reasonable. This is the litmus test—nothing more, nothing less." *Id.* at 543.

In order for the TRA to exercise its plenary authority to govern public utilities, the General Assembly has authorized the TRA to "adopt rules governing the procedures prescribed or authorized," including "rules of practice before the authority, together with forms and instructions," and "rules implementing, interpreting or making specific the various laws which [the TRA] enforces or administers." *Greer,* 967 S.W.2d at 762 (quoting Tenn.Code Ann. § 65–2–102(1) & (2) (1997 Supp.)). Pursuant to this express statutory authority, the TRA adopted the PGA Rules, described above, related to the cost of gas. "Generally, rules and regulations promulgated pursuant to statutory directive and not inconsistent with such statutes have the force of law." *Kogan v. Tenn. Bd. of Dentistry,* No. M2003–00291–COA–R3–CV, 2003 WL 23093863, at *5 (Tenn.Ct.App. Dec.30, 2003) (citing *Houck v. Minton,* 187 Tenn. 38, 212 S.W.2d 891, 895 (Tenn.1948)).

Authority to Permit the Recovery of Litigation Expenses

In this appeal, the Consumer Advocate argues that the TRA exceeded its authority when it awarded litigation expenses to the Gas Company. The Consumer Advocate contends that: (1) the Asset Management Docket was not a "rate case" and, therefore, the rationale that litigation costs can be awarded in a "rate case" is inapplicable; (2) the award of litigation expenses in that docket was not made appropriate either because it arose in the context of a rate case or because it was combined with another rate case; (3) awarding litigation expenses to a utility in a non-rate case is not authorized by statute or regulation; (4) awarding litigation expenses to the utility in a non-rate contested case hearing violates the American Rule; and (5) the award of litigation expenses in this case constituted improper retroactive ratemaking. We address these issues in turn.

The Asset Management Docket—A Rate Case?

***16** [1] To establish the premise for its main argument, the Consumer Advocate first takes the position that the Asset Management Docket was not a "rate case." In making this argument, the Consumer Advocate concedes that the TRA may permit the Gas Company to recover so-called Rate Case Expenses as part of the TRA's implied powers arising out of the legislature's express grant of authority to the TRA to "fix just and reasonable" rates.[FN30] This rationale, the Consumer Advocate contends, does not apply here because no rates were set in the Asset Management Docket. The Consumer Advocate claims that the term "rates" has a very precise meaning when used in a regulatory context, and that the TRA's power to fix rates extends only to the base rate charged for the distribution of gas to the customer, as established in a rate case. Because the Asset Management Docket was not a rate case, the Consumer Advocate insists, the TRA was without authority to award litigation expenses to the Gas Company in that docket.

> FN30. There is no statute or regulation that explicitly permits the TRA to include litigation expenses as an operating expense of the utility in a rate case. Rather, the practice of allowing Rate Case Expenses to be recovered by the utility has become the accepted "policy and custom" of the TRA. *See Tenn. Am. Water Co.,* 2011 WL 334678, at *26.

In response, Appellees claim that we need not decide whether the TRA has authority to award litigation expenses in a proceeding that is not a "rate case," because the Asset Management Docket was, in fact, a rate case.[FN31] They argue that the term "rate" is much broader than suggested by the Consumer Advocate, and that it includes base rates, charges, surcharges, gas costs, fees, and *any other mechanism* that the TRA devises for the recovery of a utility's costs from its customers. In fact, the PGA Rules refer to "demand rates" with respect to gas costs, and to the filing of a "rate change" under the PGA Rules. *See* Tenn. Comp. R. & Regs. 1220–4–7–.02(4); 1220–4–7–.03(1)(a)3(i); 1220–4–7–.03(1)(a)5(iv). The term "rates," Ap-

pellees argue, can also refer to special tariff rates, which have never been set in the context of rate cases, and the term may also include charges and fees that are in addition to the rates set in a rate case proceeding. Thus, the Appellees argue, because the power of the TRA to "fix just and reasonable" rates extends beyond the setting of base rates, and the resolution of the Asset Management Docket affected the ultimate rates charged to the consumer, the Asset Management Docket should be considered a "rate case."

> FN31. This assertion is directly contrary to the Gas Company's argument before the TRA, in which it asserted that "[t]his clearly is not a rate case."

We agree with Appellees that the TRA's power to "fix just and reasonable" rates extends beyond setting base rates in a rate case. The statutes make it clear that the TRA has very broad "general supervisory and regulatory power, jurisdiction and control over all public utilities," and it presides over all types of regulatory matters. *See* Tenn.Code Ann. § 65–4–104 (2004). However, from our review of the record, we must conclude that the Asset Management Docket cannot be characterized as a "rate case" as that term has come to be understood in the vernacular of utility regulation. It appears that a proceeding before the TRA is called a "rate case" only if it is one in which base rates are being set, *i.e.,* where the TRA fixes a base rate that balances the interest of the utility with the public interest and assures that the rate charged is just and reasonable. In the Asset Management Docket, the TRA evaluated the Gas Company's asset management practices to ensure that consumers were not being exploited; rates were neither proposed nor set.[FN32] Therefore, we cannot accept Appellees' contention that the Asset Management Docket can be characterized as a "rate case" as that term has been understood and used in the context of utility regulation.

> FN32. In testifying to the TRA, even the Gas Company's expert agreed that the Asset Management Docket "was not a traditional rate proceeding by any means, and [the Gas Company] could not reasonably estimate the cost to be incurred."

***17** [2] Furthermore, we are not persuaded by Appellees' argument that the TRA's award of litigation expenses was authorized because the Asset Management Docket "stemmed" from a rate case. The asset management issues were raised by the Consumer Advocate in Rate Case 1, and could have been decided in that docket. However, they were not decided in that docket. It is undisputed that the estimated litigation expenses incorporated into the rate that was set in Rate Case 1 did not include fees for the litigation of the asset management issues.[FN33] Instead, the asset management issues were transferred and resolved in their own separate docket, apart from the setting of base rates.[FN34]

> FN33. Had the issues been decided in those proceedings, the Gas Company presumably would have increased the amount of estimated Rate Case Expenses for the docket and would have incorporated those expenses in proposing a just and reasonable rate.
>
> FN34. Neither party challenged the TRA's authority to transfer the asset management issues into a docket separate from the rate case.

[3] Likewise, we decline to accept Appellees' argument that the award of litigation expenses by the TRA was authorized because the litigation expenses were awarded "in the context of a rate case." After the merits of the asset management issues raised by the Consumer Advocate were decided, the question of the Gas Company's litigation expenses was transferred to Rate Case 2, in part so that the litigation expenses could be decided "in the context of a rate case."[FN35] This transfer, however, did not transform the Asset Management Docket into a "rate case." In fact, the issue of whether the Gas Company could recover Asset Management Docket litigation expenses was presented and decided sep-

arately from the rate case issues in that docket.[FN36] Accordingly, we decline to adopt Appellees' argument, and we must conclude that the TRA's award of the Gas Company's litigation expenses was not made in a rate case or in the equivalent of a rate case.

> FN35. The Manufacturer's Association was interested in having the matter transferred into a rate case in order to give the public notice and an opportunity to be heard on the issue, and because the Manufacturer's Association argued that the TRA had no authority to award the Gas Company its litigation expenses unless it filed a rate case. Because the public was notified, and because the TRA duly considered the issue in a rate case, the Manufacturer's Association does not challenge the TRA's exercise of its discretion in awarding the Gas Company its just and reasonable litigation expenses incurred in the Asset Management Docket.

> FN36. As in Rate Case 1, the litigation expenses incurred in Rate Case 2 were incorporated into the just and reasonable rate that was fixed by the TRA, but the litigation expenses incurred in the Asset Management Docket were not included.

Authority to Award Litigation Expenses in A Non–Rate Case

[4] The issue then becomes whether the TRA had the authority to permit the Gas Company to recover its litigation expenses in a proceeding that was not a "rate case." The Consumer Advocate argues that there is no authority, either express or implied, for the TRA to permit a utility to recover its litigation expenses in a case in which base rates are not being set. It argues that the award of litigation expenses in this case was "far different" from an award of normal operating expenses incurred in a rate case, and that no statutory or regulatory provision exists that permits the Gas Company to recover litigation expenses that it incurred in a non-rate case. The Consumer Advocate argues that the TRA's action in permitting the Gas Company to recover litigation expenses in a non-rate case was a dramatic change in regulatory practice, and that the TRA must clearly explain the basis of its authority to make such a change rather than merely relying on its general authority or citing the fact that the underlying litigation was "complex." The Consumer Advocate emphasizes that customers' bills are comprised of only two charges: the cost of delivering the gas, reflected in the base rate, and the cost of gas, determined by the application of the PGA Rules. Because the Gas Company's litigation expenses were not awarded either as an element of the base rate charged or through the application of the PGA Rules, the Consumer Advocate contends, the TRA was without authority to award the Gas Company the litigation expenses it incurred in the Asset Management Docket.

***18** The Appellees approach the issue from a different perspective. They note that the TRA has been given plenary authority to govern and supervise utilities, and they argue that nothing in the statutes or the regulations *prohibits* the TRA from allowing a utility to recover litigation expenses incurred in a non-rate regulatory proceeding. The Appellees emphasize that this Court must not interfere with a decision by the TRA unless the TRA has clearly exceeded its authority, and that where there is "any doubt as to the existence or extent of a power conferred on the [TRA] ... [such doubt] shall be resolved in favor of the existence of the power." Tenn.Code Ann. § 65–4–106. The TRA is clearly authorized to allow a utility to recover reasonable and prudent operating costs that are necessary to the utility's provision of gas to its customers, they argue, and this may include reasonable and prudent regulatory commission expenses, as that term is defined in the NARUC system of accounting. In addition, Appellees claim that, if a utility is not permitted to recover reasonable and prudent regulatory commission expenses incurred in an extraordinary and unusually complex proceeding, then the rates set by the TRA will end up being confiscatory, be-

cause the utility would have no way of recovering an extraordinary, legitimate cost of doing business. The Appellees point out that the Gas Company was left no choice but to expend a considerable amount of time and resources defending against the allegations of the Consumer Advocate in the Asset Management Docket, allegations which, as it turned out, were based on neither fact nor credible data.[FN37] Consequently, the TRA had the authority to allow it to recover the reasonable and prudent regulatory commission expenses in that case.

FN37. The Gas Company notes that the Consumer Advocate withdrew the majority of the evidence supporting its claims ten days before the final hearing.

In support of its argument on appeal, the Consumer Advocate cites *Kingsport Power Company,* the case on which Mr. Buckner relied in support of his testimony. In *Kingsport Power,* a consumer association intervened in a proceeding before the Public Service Commission, the predecessor of the TRA.[FN38] After the matter was concluded, the consumer association filed a request with the Commission to recover the litigation costs it had incurred in the underlying proceeding, pursuant to the federal Public Utility Regulatory Practices Act of 1978 ("PURPA"), 16 U.S.C. § 2632. This statute permitted a consumer to seek reimbursement for attorney fees and other litigation costs from the utility if the consumer participated in a regulatory hearing and made a "substantial" contribution, in whole or in part, to the Commission's decision.[FN39] *Kingsport Power,* 1985 WL 1105936, at *1. The Public Service Commission denied the consumer association's request, stating: "The Commission has no statutory authority from the Tennessee legislature to award litigation costs to any party." *Id.* It found, however, that the consumer association would have been entitled to its litigation fees *if* the Commission had the jurisdiction to award them. The consumer association filed an appeal to have the Public Service Commission's decision reviewed by the chancery court.

FN38. The exact nature of the proceeding is unclear, because no record of the regulatory proceeding or evidence from the trial court was filed with the appeal. *Kingsport Power,* 1985 WL 1105936, at *1.

FN39. The consumer was permitted to collect these fees by bringing a civil action against the utility in state court or by requesting an award of costs from the Commission. *Kingsport Power,* 1985 WL 1105936, at *1.

***19** On appeal, the chancery court in *Kingsport Power* agreed with the Public Service Commission, holding that it had no authority to award litigation expenses to the consumer association. Because the Public Service Commission had no jurisdiction to award the relief sought, the chancery court held that the consumer association was not "aggrieved" by the Commission's decision and, therefore, had no standing to appeal. *Id.* at *2. The consumer association appealed to this Court. On appeal, this Court held that the chancery court did not have subject matter jurisdiction over the appeal from the Public Service Commission's order, because "there was no contested case for the court to review, and nothing before the court below to invoke its jurisdiction." *Id.* at *3. Accordingly, the appellate court held that it lacked subject matter jurisdiction over the appeal, and dismissed the appeal on that basis. *Id.*

In the case at bar, the Consumer Advocate relies on the pronouncement by the Public Service Commission recounted in *Kingsport Power,* with which the chancery court apparently agreed, to the effect that the Public Service Commission had no authority to award litigation costs to any party.[FN40] *Id.* at *1. After considering *Kingsport Power,* we must respectfully conclude that it is inapposite in this case. First, *Kingsport Power* involved a request for litigation expenses pursuant to a federal statute not at issue in the case at bar. More importantly, the substantive issue in *Kingsport Power* involved the consumer association's right to recover litigation expenses *from the utility,* not the utility's

right to recover its operating costs from consumers through gas rates. Thus, the statement by the Public Service Commission on which the Consumer Advocate relies must be viewed in that context. For these reasons, we find that *Kingsport Power* does not support the Consumer Advocate's position in this appeal.[FN41]

> FN40. The same Public Service Commission order stated: "No Tennessee statute confers on the Commission the authority to set attorney fees, expert witness fees, and other litigation costs *and assess these costs against the regulated utility.*" *Kingsport Power,* 1985 WL 1105936, at *1 (emphasis added).
>
> FN41. Interestingly, in *Kingsport Power,* the Public Service Commission indicated in its order that, if the utility had voluntarily paid the consumer group its attorney fees, it would have treated that "expense as an operating cost of the utility." This comment seems to indicate that, had the utility been compelled to pay the litigation expenses of the consumer group under PURPA, the utility would have been able to recover that expense from its customers in the manner that the Gas Company seeks to recover its litigation costs in the instant case.

Aside from its reliance on *Kingsport Power,* the Consumer Advocate insists that the TRA did not have the authority to permit the Gas Company to recover its asset management litigation expenses, because those expenses were not recovered either through the setting of rates or through the PGA mechanism. The Consumer Advocate cites no authority that limits the TRA's authority to these two means of permitting a utility to recover its costs. Appellees, on the other hand, do not cite any specific statute or regulation authorizing the TRA to award asset management litigation expenses. Appellees rely instead on the broad general grant of power to the TRA.

Overall, from our review of the statutes granting authority to the TRA, the regulations, the caselaw, and the record in this case, we are persuaded that the Appellee's perspective on the issues raised on appeal is correct. The authority granted to the TRA in this arena is clearly intended to be plenary. The onus, then, is on the Consumer Advocate to show a limitation on that plenary authority given to the TRA, and it has not done so.

***20** Caselaw and other TRA proceedings indicate that the TRA's authority is not limited as the Consumer Advocate insists. The power to "fix just and reasonable" rates is certainly one of the TRA's primary responsibilities in governing utilities. Indeed, the task of ratemaking has been delegated totally to the TRA, and the TRA invests much of its resources into the ratemaking process. *See CF Indus.,* 599 S.W.2d at 542. However, we agree with Appellees that the power granted by the legislature to the TRA in Section 65–5–101 is not limited to the setting of base rates. Rather, the statute directs the TRA to "fix just and reasonable individual rates, joint rates, tolls, fares, charges or schedules thereof, as well as commutation, mileage, and other special rates...." Tenn.Code Ann. § 65–5–101. The statutory grant of authority suggests that, while the TRA's plenary power to supervise and regulate utilities *includes* the setting of base rates, its power is not *limited* to setting base rates. The statute indicates that the TRA has authority over all rates charged to customers, and that the TRA must be able to take any actions necessary in those proceedings to effectuate its decisions. *See BellSouth Adver. & Pub'g Corp.,* 79 S.W.3d at 506.

As explained above, the Gas Company's asset management practices directly affect the ultimate charges to the consumer, in that the Gas Company's profits from the sale of excess assets are passed on to the consumer, and they affect the reasonableness of the rates set out in the Gas Company's tariff through the charges or credits resulting from the IMCR.[FN42] This is why the underlying issues were raised in a rate case in the first instance—because

asset management practices affect the ultimate rates charged to customers. The fact that the Asset Management Docket was *not* a rate case did not strip the TRA of its authority to allow the Gas Company to recover its litigation expenses incurred in that docket as a cost of doing business.

> FN42. As we discuss in more detail in the analysis of the final issue on appeal, the asset management fund represents profits due to consumers from the Gas Company's asset management practices; it is not calculated by reference to the "cost of gas" calculations in the PGA Rules. Therefore, we do not agree with the Consumer Advocate's assertion that the TRA lacked authority to allow the Gas Company to recover its litigation expenses based on the absence of a PGA Rule permitting such recovery.

It is undisputed that the TRA had the authority to preside over the Asset Management Docket and to address the propriety of the Gas Company's asset management practices. The Gas Company had little choice but to participate in the Asset Management Docket to defend its asset management practices against allegations that they were not in the best interest of the consumer. At the conclusion of the proceedings, the TRA did not find any improper asset management practices by the Gas Company.[FN43] In fact, after nearly two years of proceedings, the Consumer Groups withdrew the testimony of the petitioners' main expert on the subject, shortly before the final hearing. The TRA considered the approximately $745,000 in litigation expenses incurred by the Gas Company in defending its asset management practices to be an unusual, extraordinary expense of the utility that was necessary, reasonable, and prudent.[FN44] If the TRA were not permitted to allow the Gas Company to recover these and other reasonable extraordinary operating costs, this would prevent the TRA from fulfilling its responsibility to ensure that the base rate charged by the utility covers the utility's operating expenses and provides a reasonable rate of return. Thus, in order to "fix just and reasonable" rates, the TRA must have the authority to permit a utility to recover reasonable and prudent extraordinary expenses.

> FN43. The TRA ordered a future review of the Gas Company's asset management practices, but we do not interpret this as a finding that any of its practices were improper.
>
> FN44. Again, the reasonableness of the litigation expenses is not an issue before this Court.

***21** The parties have not cited a case in which the TRA permitted a utility to recover its litigation expenses in a non-rate proceeding, and we have not found one. However, other TRA proceedings show that it is not unusual for the TRA to exercise its authority to permit a utility to recover one-time, extraordinary costs. For example, in TRA Docket No. 10–00107, In Re: Petition of Condo Villas of Gatlinburg Association, Inc. d/b/a Foothills Water Properties for Emergency Relief for Water Rates, Condo Villas requested emergency relief from the TRA. Condo Villas sought to recover for an unexpected, extraordinary loss of $15,810 caused by extreme weather conditions that caused a water line to break, and ultimately resulted in the loss of millions of gallons of water. Condo Villas sought permission from the TRA to assess a one-time fee of $155 to each of its 102 customers in order to recover this extraordinary expense. The Consumer Advocate intervened in the proceeding, and a hearing was conducted. The TRA granted Condo Villas the relief it requested. The TRA observed that, "for large utilities, changes in expenses are expected and are generally easy for the utility to absorb until a rate case filing." However, because Condo Villas was small and could not absorb the unexpected expenses at issue, the TRA permitted the one-time assessment it requested.

In TRA Docket No. 07–00007, Lynwood Utility Corporation filed a petition to increase its rates. In the course of those proceedings, consumers com-

plained about odors arising from Lynwood's wastewater treatment facility. The Consumer Advocate intervened, and the parties reached a settlement of the rate case. The TRA approved the settlement, but it directed Lynwood Utility to file a petition to recover the costs associated with the resolution of the consumers' odor complaints. Accordingly, the utility filed Docket No. 08–00060, In Re: Petition of Lynwood Utility Corporation for Approval of a Cost Recovery Mechanism for Deferred Odor Elimination Costs, to recover those costs. Subsequently, the Consumer Advocate and the utility reached an agreement about the odor elimination costs recoverable by the utility. In this proceeding, there is no indication that the Consumer Advocate questioned the TRA's authority to defer odor elimination costs and recover those costs in another docket outside of a rate-setting case.

In Docket No. 07–00081, Petition of Atmos Energy Corporation for Approval of Tariff Establishing Environmental Cost Recovery Rider ("ECRR"), Atmos Energy sought permission from the TRA to recover over a period of three years $2.7 million expended to cleanup specific environmental sites through an ECRR. The Consumer Advocate intervened. The parties reached an agreement for Atmos Energy to recover $1.65 million over a period of four years, and the Consumer Advocate consented to the TRA's approval of an ECRR that provided for a recovery period of four years. Once again, there is no indication that the TRA's authority to permit the utility to recover extraordinary costs through the addition of a rider to the tariff was challenged in this proceeding.

***22** Of course, none of these regulatory proceedings directly establishes the TRA's authority to allow the Gas Company to recover litigation expenses in a non-rate case.[FN45] They do, however, demonstrate the manner in which the TRA has addressed extraordinary costs in the past, and that the setting of base rates is not the only proceeding in which a utility has been allowed to recover costs .[FN46]

FN45. The Consumer Advocate correctly points out that these cases involved a utility's request for a charge or assessment related to providing utility service, not to incurring litigation expenses in a regulatory proceeding.

FN46. After granting the TRA broad authority over the governance of utilities, the General Assembly has not taken legislative action to curtail the exercise of that authority. Legislative silence on the subject can be interpreted as indicating legislative approval of the *status quo*. *See Purkey v. Am. Home Assurance Co.,* 173 S.W.3d 703, 709 (Tenn.Ct.App.2005) (stating that Legislature is presumed to be aware of state law and, by its silence, it intended to preserve the *status quo*).

We also find that the NARUC system of accounting gives credence to the Appellees' argument that regulatory commission expenses may be recovered by a utility if they are prudent and reasonable. The definition of "regulatory commission expense," which is considered an ordinary operating expense, does not differentiate between litigation expenses incurred in a "rate case" or those incurred in other types of regulatory cases. Rather, regulatory commission expenses explicitly include "expenses of counsel, solicitors, or attorneys ... engaged in the ... defense against petitions or complaints presented to regulatory bodies...." This accounting principle does not, of course, authorize a utility to recover these operating expenses in every case; rather, it reflects an understanding in the regulated utility industry that these regulatory commission expenses are simply a cost of doing business. If the TRA deems it to be appropriate to permit the Gas Company to recover for this cost in a given proceeding, then it has the authority to allow such recovery.

The Consumer Advocate argues that, even if the TRA had the authority to award the Gas Company its Asset Management Docket litigation ex-

penses, it did not properly exercise its authority because it did not explain the reason for its decision. It argues that a mere finding that the docket was "complex" or "protracted" is an insufficient basis on which to make such an award. We disagree. It is undisputed that the litigation expenses incurred in the Asset Management Docket proceedings were complex and that the Gas Company was compelled to participate. The amount of the Gas Company's litigation expense is not disputed on appeal. We find that the TRA's reasons in the record for awarding the Gas Company its litigation expenses in this case was sufficient, and its actions were not arbitrary or capricious.[FN47]

> FN47. This is unlike the situation in *Tennessee American Water Co.,* wherein the final order of the TRA was "devoid of" reasons for denying half of the rate case expenses requested in that case. *See* 2011 WL 334678, at *27.

Given the TRA's plenary authority to regulate utilities, and the absence of a statute, regulation, or other authority prohibiting the TRA's actions, we hold that the TRA had the authority to permit the Gas Company to recover from its customers the reasonable and prudent litigation expenses incurred in the Asset Management Docket.[FN48]

> FN48. The Consumer Advocate cites various policy reasons for its argument that the TRA *should not* have awarded litigation expenses. Such policy decisions are beyond the authority of this Court to consider.

The American Rule

[5] The Consumer Advocate argues that the TRA's award of litigation expenses in the Asset Management Docket violates the American Rule that each party should bear his own legal costs absent a contrary contractual or statutory provision. *See House v. Estate of Edmondson,* 245 S.W.3d 372, 377 (Tenn.2008). The American Rule is not at issue in this case. As explained in our analysis of this Court's decision in *Kingsport Power,* the TRA did not "award" fees to a "prevailing party," *i.e.,* it did not order the Consumer Groups to pay anything to the Gas Company.[FN49] Rather, it permitted the utility to recover from its customers the utility's reasonable and prudent litigation expenses. This argument is without merit.

> FN49. The Consumer Advocate further argues that the American Rule is effectively codified in the Uniform Administrative Procedures Act, which provides that "any party may be advised and represented *at the party's own expense* by counsel" in a contested case. Tenn.Code Ann. § 4–5–325 (emphasis added). Similarly, the TRA regulations include a provision stating that "[a]ny party to a contested case may be advised and represented, at the party's own expense, by a licensed attorney or attorneys." Tenn. Comp. Rules & Regs 1220–1–2–.04(1). For the same reasons, neither this statute nor this regulation applies to the TRA's decision to permit the Gas Company to recover litigation expenses from its customers.

Retroactive Ratemaking

***23** [6] The Consumer Advocate argues that the TRA has the power to set base rates only on a going-forward basis; that is, rates may not be temporary or subject to a retroactive review that would require, in effect, either a refund by the company or an additional payment by consumers. *See South Central Bell v. Tenn. Pub. Serv. Comm'n,* 675 S.W.2d 718 (Tenn.Ct.App.1984). The Consumer Advocate claims that, because the TRA awarded litigation expenses based on the fact that the Asset Management Docket "stemmed" from Rate Case 1, and then allowed the Gas Company to recover litigation expenses from that proceeding after Rate Case 1 was closed, the TRA in essence allowed the utility to recover a "refund" from the proceeding. This decision, the Consumer Advocate argues, constituted impermissible retroactive ratemaking for which the TRA has no authority.

As noted above, the TRA's authority to allow the Gas Company to recover its Asset Management Docket litigation expenses was not based on the fact that it "stemmed" from a rate case. Rather, the TRA had the authority to permit the Gas Company to recover as an extraordinary operating expense the litigation expenses incurred in the Asset Management Docket. This argument is likewise without merit.

Authority to Allow Recovery From Asset Management Funds

[7] The Consumer Advocate argues that the TRA did not have authority to order that the Asset Management Docket litigation expenses incurred by the Gas Company be paid from asset management funds, because this method of recovery is accounted for in the PGA Rules, and the PGA Rules make no provision for the recovery of litigation costs as a part of the cost of gas. The Consumer Advocate argues that the PGA Rules specifically enumerate the items that can be recovered as a part of the cost of gas. *See* PGA Rule 1220–4–7–.01 (definition of "gas costs"). It claims that the PGA Rules cannot be altered at the discretion of the TRA, but can only be changed through a "rulemaking" procedure. Because the Gas Company never sought to alter or amend the IMCR through a rulemaking procedure, the Consumer Advocate contends, the TRA in effect "changed a tariff to the detriment of consumers without notice or a hearing." For these reasons, the Consumer Advocate argues, the TRA exceeded its authority when it ordered that the Asset Management Docket litigation expenses be paid out of asset management funds.

We respectfully disagree. The asset management fund exists because of the Gas Company's asset management practices. It represents profits from the sale of gas and does not involve the cost of gas. We have already held that the TRA was authorized to allow the utility to recover the legal expenses it incurred in the Asset Management Docket. In its order, the TRA concluded that the most appropriate means of recovery for the Gas Company would be from the asset management fund:

> The panel determined that the most equitable method for the Company to recover these costs would be from asset management funds. Allowing recovery of legal expenses from asset management funds is an appropriate accounting treatment for the non-recurring legal expense and also provides the Company a more timely recovery of legal expenses it has already paid. The panel determined the recovery of legal expenses should come from the consumer's share of earnings from the asset management fund, rather than through a recurring charge on their monthly bill. Thereafter, the panel voted unanimously that recovery of legal expenses should be from asset management funds.

***24** As explained above, the asset management practices are set forth in the IMCR, and consumers receive the benefit of their share of asset management funds through the provisions of the IMCR. Although the Consumer Advocate argues that the litigation expenses awarded must come "through the PGA mechanism," the reimbursement to the Gas Company of its litigation expenses will be made before the asset management funds are processed through the IMCR or the PGA mechanism. The IMCR provides that "gross profit margin *losses* shall be recovered from the firm commodity component of gas costs as determined under the presently effective Purchased Gas Adjustment Provision." (Emphasis added). The IMCR does not provide that the asset management funds are part of the PGA mechanism. FN50

> FN50. We are mindful of Mr. Hickerson's testimony that the refund would be accounted for under the Actual Cost Adjustment component of the PGA. They would not be accounted for in this way, however, if they were first paid to the Gas Company as directed by the TRA.

Moreover, in the TRA's order, a variety of Gas

Company expenses were ordered to be recovered from asset management funds, including expenses for energy conservation and education. The Consumer Advocate does not contest the TRA's authority to order the recovery of these costs via asset management funds. In the absence of any express limitation on this exercise of the TRA's discretion in this way, we conclude that the TRA has the authority to order that allowable expenses such as the Asset Management Docket litigation expenses be paid from asset management funds, by virtue of its plenary power to set rates and govern and regulate utilities. Therefore, we conclude that the TRA did not exceed its authority in ordering that the extraordinary litigation expenses incurred in defending the Gas Company's asset management fund practices be recovered from asset management funds.

CONCLUSION

The decision of the TRA is affirmed. Costs on appeal are to be taxed to Appellant Consumer Advocate and Protection Division of the Office of the Attorney General of Tennessee and its surety, for which execution may issue, if necessary.

Tenn.Ct.App.,2012.
Consumer Advocate & Protection Div. of Office of Atty. Gen. of Tennessee v. Tennessee Regulatory Authority
Slip Copy, 2012 WL 1964593 (Tenn.Ct.App.)

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