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January 22, 2015

VIA ELECTRONICALLY

Hon. Herbert H. Hilliard, Chairman
Tennessee Regulatory Authority
c/o Sharla Dillon, Dockets and Records Manager
502 Deaderick Street, 4th Floor
Nashville, TN 37243

RE: In Re: Petition of Piedmont Natural Gas Company, Inc. for Approval of a CNG Infrastructure Rider to its Approved Rate Schedules and Service Regulations, TRA Docket No. 14-00086

Dear Chairman Hilliard:

Attached for filing please find the *Post-Hearing Brief of the Tennessee Fuel and Convenience Store Association* in the above-captioned matter.

As required, an original of this filing, along with four (4) hard copies, will follow. Should you have any questions concerning this filing, or require additional information, please do not hesitate to let me know.

Very truly yours,

BUTLER SNOW LLP

Melvin J. Malone

clw
Attachment
c: Parties of Record

The Pinnacle at Symphony Place
150 3rd Avenue South, Suite 1600
Nashville, TN 37201

MELVIN J. MALONE
615.651.6705
melvin.malone@butlersnow.com

T 615.651.6700
F 615.651.6701
www.butlersnow.com

BEFORE THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE

IN RE:	)	
	)	
PETITION OF PIEDMONT NATURAL	)	
GAS COMPANY, INC. FOR APPROVAL	)	
OF A CNG INFRASTRUCTURE RIDER	)	**DOCKET NO. 14-00086**
TO ITS APPROVED RATE SCHEDULES	)	
AND SERVICE REGULATIONS	)	

POST-HEARING BRIEF OF THE TENNESSEE FUEL AND CONVENIENCE STORE ASSOCIATION

Pursuant to the Procedural Schedule established by the Tennessee Regulatory Authority ("TRA" or "Authority") in this matter,[1] the Tennessee Fuel and Convenience Store Association ("TFCA") respectfully submits its Post-Hearing Brief. For the reasons set forth below, TFCA respectfully submits that the Petition of Piedmont Natural Gas Company, Inc. in the above-captioned consolidated docket (the "*Petition*") should be denied and Rate Schedule 342 should be terminated.[2]

I.

BACKGROUND

A. The Tennessee Fuel and Convenience Store Association

Originally chartered in 1929, TFCA currently represents more than two hundred fifty (250) member companies, including wholesalers, retailers, truck stops, heating oil businesses, lubricant distributors and bulk storage facilities, as well as the many companies that supply

[1] This matter has been consolidated by the Authority with *In Re: Tariff to Revise the Natural Gas Vehicle Fuel Tariff and Introduce An Experimental Motor Vehicle Fuel Service Tariff*, TRA Docket No. 14-00087.

[2] To ease the administrative burden upon the Authority and to comply with the due date of the post-hearing briefs, TFCA incorporates by reference, as if set forth fully herein, its previously submitted support and arguments in this case. To the extent TFCA does not expressly address an issue in this case in its post-hearing brief, TFCA relies on its previously submitted support.

products and services to these businesses. TFCA members offer varieties of vehicular fuel for sale to the general public throughout the State of Tennessee, including in the area in which Piedmont transports, distributes and sells natural gas to Tennessee consumers, and TFCA competes against other businesses that provide vehicle fuel for sale to the general public. Many TFCA members are natural gas customers of Piedmont Natural Gas Company, Inc. ("Piedmont").[3] Both TFCA's and the Consumer Advocate and Protection Division of the Tennessee Attorney General's Office's ("CAPD") petitions to intervene in this matter were granted by the Authority.[4]

B. The Statute

Tennessee Governor Bill Haslam signed House Bill 191, now Tenn. Code Ann. § 65-5-103, into law on April 19, 2013. Among other things, this legislation authorized the TRA to implement alternative regulatory methods to allow public utility rate reviews and cost recovery mechanisms in lieu of a general rate case proceeding before the agency. In general, the statute is intended to reduce the need for general rate cases, lessen the occurrence of consumer rate shock, support the maintenance and improvement of essential infrastructure, ensure safety and reliability, aid economic development and allow for more efficient, streamlined regulation.

By its own terms, § 65-5-103(d) establishes a two-step review process. First, the petition must comply with the language and intent of the statute. Second, the petition must be found by this Authority to be in the public interest. By establishing this two-pronged process, the Tennessee General Assembly, consistent with Tennessee courts, recognized that the Authority's

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[3] *See Notice of Filing of TFCA in Response to the Authority's October 3, 2014, Order Granting Petitions to Intervene filed by the CAPD and TFCA*, TRA Docket No. 14-00086 (Oct. 6, 2014) (submitted **UNDER SEAL** and marked **CONFIDENTIAL**).

[4] *Order Granting Petitions to Intervene filed by the CAPD and TFCA, In Re: Petition of Piedmont Natural Gas Company, Inc. for Approval of a CNG Infrastructure Rider to its Approved Rate Schedules and Service Regulations*, TRA Docket No. 14-00086 (Oct. 2, 2014).

experience, knowledge and expertise should be given appropriate deference in the area of utilities and utility regulation.[5] In fact, it is well-settled that the Authority and its staff have "in their grasp practical knowledge in the field of utilities regulation not possessed by either the courts or laymen in general."[6] By enacting two levels of review, the General Assembly acknowledged the possibility that there may be circumstances in which a proposed mechanism may satisfy the first level of analysis — compliance with the language and intent of the statute — yet fail the public interest test.

C. How the Statute Is Designed to Work

Section 65-5-103 is a good statute with laudable purposes. It is likely true that few, if any, statutes are perfect. Even still, when applied as intended by the Tennessee General Assembly, § 65-5-103 works. Shortly after the passage of § 65-5-103, and pursuant to the statute, the Authority approved an alternative ratemaking mechanism submitted by Piedmont.[7] Moreover, in TRA Docket No. 13-00130, the Authority approved additional alternative ratemaking mechanisms proposed by Tennessee-American Water Company under the statute.[8]

In reviewing the petitions submitted in TRA Docket Nos. 13-00118 and 13-00130, the Authority, as it is required to do, employed the two-step inquiry established in § 65-5-103.[9]

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[5] *See, e.g., Tennessee Am. Water Co. v. Tenn. Regulatory Auth.*, No. M2009-00553-COA-R12-CV, 2011 Tenn. App. LEXIS 51 at *63 (Tenn. Ct. App. Jan. 28, 2011) ("[W]e accord the Commission great deference in reviewing its decisions.") (*quoting CF Industries v. Tennessee Pub. Serv. Comm.*, 599 S.W.2d 536, 541 (Tenn. 1980)). *See also, e.g., CF Industries*, 599 S.W.2d at 543 (The Commission "may superimpose upon the entire transaction its own expertise, technical competence and specialized knowledge.").

[6] *Tennessee Am. Water Co.*, 2011 Tenn. App. LEXIS 51 at *64.

[7] *See Order Granting Petition*, In Re: Petition of Piedmont Natural Gas Company, Inc. for Approval of an Integrity Management Rider to its Approved Rate Schedules and Service Regulations, TRA Docket No. 13-00118 (May 13, 2004) (hereinafter "*Order Granting Petition*").

[8] *Transcript of Proceedings, In the Matter of Tennessee Regulatory Authority Conference*, TRA Docket No. 13-00130, pp. 14-16 (April 14, 2014) (excerpt) (hereinafter "*TAWC Hearing Tr.*").

[9] *See Order Granting Petition*, p. 10 ("Based on the record in this docket, arguments made by counsel, and witness testimony presented at the Hearing, the panel found that the revised IMR tariff of Piedmont complies with Tenn. Code Ann. § 65-5-103(d)(2) **AND** is in the public interest.") (*emphasis added*).

First, the agency analyzed the petitions for compliance with § 65-5-103 *et seq.*[10] Second, the Authority conducted a public interest inquiry to determine whether the petitions in question satisfied § 65-5-103's public interest test.[11] So, as evidenced by the actions of the Authority shortly after passage of the statute, the statute works.

The Authority's role is to carry out those matters delegated to it by the Tennessee General Assembly.[12] Based on the evidence, and Authority precedent regarding § 65-5-103, to do what Piedmont is requesting here would require the Authority to superimpose its opinion over the intent of the Tennessee General Assembly.

II.

PIEDMONT'S PETITION FAILS THE STATUTE'S TWO-PRONGED REVIEW

As will be demonstrated below, the problems with this case do not rest with the statute. Rather, the problems underlying this case lie solely within the four corners of the *Petition*. As submitted to the Authority, and as evidenced by the record, Piedmont's *Petition* fails both prongs of the two-part review established in § 65-5-103(d).

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[10] *See Order Granting Petition* at p. 8 ("The panel found that Piedmont's Petition complies with Tenn. Code Ann. § 65-5-103(d)(2)[A](i)(ii), and the record clearly establishes that its capital expenditures related to TIMP and DIMP compliance are mandatory safety requirements imposed by the federal government."); and *TAWC Hearing Tr.* at pp. 14-15 (The Authority found that "[T]he amended petition and specifically the tariffs . . . meet the requirements of . . . § 65-5-103.").

[11] *See Order Granting Petition* at p. 9 ("The panel finds that approval of the IMR is in the public interest because it should eliminate the need for rate case filings in order to recover the costs associated with federal safety requirements. Further, eliminating frequent rate case filings will also eliminate recovery of the associated legal expenses from ratepayers, thereby lessening the financial burden to ratepayers. In addition, the IMR mechanism will allow Piedmont to recover the funds necessary to repair and replace necessary plant in a timely manner which will result in safe and reliable service to customers."); and *TAWC Hearing Tr.* at p. 15 (The Authority found that "the three proposed investment riders not only allow the timely recovery of costs of necessary infrastructure, but also will aid in avoiding or delaying expensive rate cases. Further, the recovery of expenses - - of expense changes via the pass-through mechanism from year to year should also aid in delaying or avoiding rate cases. Accordingly, [we] find the amended petition to be in the public interest.").

[12] *Tennessee Am. Water Co.*, 2011 Tenn. App. LEXIS 51, at *35 and 38 (The court noted that the TRA's actions are "legislative in character" and that ratemaking is a "legislative function.").

A. The Burden of Proof Rests with Piedmont

It is well-settled that the petitioner, here Piedmont, has the burden of proof in this matter.[13] As evidenced by the record, and as shown below, Piedmont has simply not carried its burden and thus the *Petition* should be denied.

B. Under the First Prong of Review, the Petition Must Comply with the Statute

As set forth above, before a petition under § 65-5-103(d) is approved by the Authority, the Authority must first find that the petition complies with the statute. Concisely stated, in its *Petition*, and accompanying proposed tariffs, Piedmont, a regulated utility, is requesting a proposed infrastructure rider mechanism under § 65-5-103(d)(3)(A) to permit accelerated recovery of capital costs of investment in compressed natural gas ("CNG") facilities and equipment.[14] The stated purpose of Piedmont's investment in CNG facilities and equipment is to facilitate the broader availability of CNG to the public.[15] According to the *Petition* and Piedmont Witness Pia Powers,[16] the request in the *Petition* is based upon Tenn. Code Ann. § 65-5-103(d)(3)(A), which provides as follows:

> A public utility may request and the Authority may authorize a mechanism to recover the operational expenses, capital costs or both related to the expansion of infrastructure for the purpose of economic development, if such expenses or costs are found by the Authority to be in the public interest. Expansion of economic development infrastructure may include, but is not limited to, [] infrastructure and equipment associated with alternative motor vehicle transportations fuel[.]

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[13] TRA Rule 1220-1-2-.16(2) ("The burden of proof shall be on the party asserting the affirmative of an issue[.]"). *See also, e.g. Tennessee Am. Water Co.*, 2011 Tenn. App. LEXIS 51 at *42 ("In ratemaking proceedings, the burden of showing the proposed rates are just and reasonable rests with the utility seeking the change in rates.").

[14] *In The Matter Of: Tennessee Regulatory Authority Docket Nos. 14-00086 and 14-00087*, Transcript of Proceedings, 1A at pp. 24-25 (Jan. 12, 2015) (Hearing Testimony of Piedmont Witness Kenneth Valentine) (hereinafter "*Piedmont Hearing Tr. 1A*").

[15] *Petition* at ¶ 5.

[16] *See Piedmont Hearing Tr. 1A* at pp. 36 – 37 (Hearing Testimony of Piedmont Witness Pia Powers).

As noted earlier herein, the *Petition* must undergo the two-step scrutiny established in the statute by the General Assembly. First the *Petition* must be found to comply with § 65-5-103. Contrary to Piedmont's assertions, the *Petition* is not in compliance with the statute.

1. The Statute is Ambiguous

As conceptcd by Piedmont, its request would establish an alternative rate mechanism by which Piedmont would recover — on an accelerated basis — the capital costs of its investment in CNG facilities and equipment by incorporating these capital costs into its natural gas distribution rate base and by increasing the rates of its natural gas heating and cooling ratepayers.[17] In other words, under the proposed mechanism, Piedmont's ratepayers would fund Piedmont's entry into a separate, competitive line of business. Namely, the rates paid by Piedmont's natural gas customers would increase as a result of moving Piedmont's CNG capital costs into its natural gas distribution rate base and the rates paid by Piedmont's CNG fueling customers would be reduced.[18]

A cross-subsidization is the practice of charging higher prices to one group of consumers in order to subsidize lower prices for another group.[19] Piedmont's proposal is a cross-subsidy because the rates paid by Piedmont's captive natural gas ratepayers will be increased to recover Piedmont's investment in CNG, which will result in lower rates paid by Piedmont's CNG fueling customers.[20] While § 65-5-103(d)(3)(A) certainly allows for the recovery of capital costs related

[17] *Pre-filed Testimony of TFCA Witness Dr. Scott Carr*, TRA Docket No. 14-00086 at p. 5, LL 5-14 (Dec. 11, 2014). *See also, e.g., Pre-filed Testimony of Piedmont Witness Powers* at p. 3, L 14 through p. 4, L10.
[18] *Pre-filed Testimony of TFCA Witness Dr. Carr* at p. 8, LL 1 - 6. *See also, e.g., Piedmont Hearing Tr. 1B* at pp. 71 – 72 (Hearing Testimony of TFCA Witness Dr. Carr); *Pre-filed Testimony of TFCA Witness Ron Jones*, TRA Docket No. 14-00086 at p. 6, LL 6 – 12, and p. 20, LL 15-18 (Dec. 11, 2014) ("Piedmont's proposal would result in Piedmont's regulated natural gas customers, including low income customers and customers who qualify for gas payment assistance, subsidizing CNG motor fuel stations."); *Pre-filed Testimony of CAPD Witness William Novak*, TRA Docket No. 14-00086 at p. 12, LL 14-15 (Dec. 5, 2014); and *Pre-filed Testimony of CAPD Witness Dr. Chris Klein*, TRA Docket No. 14-00086 at p. 6, LL 1 - 5 (Dec. 5, 2014).
[19] *Pre-filed Testimony of TFCA Witness Dr. Carr* at p. 7, LL 13 - 14.
[20] *Pre-filed Testimony of TFCA Witness Dr. Carr* at p. 7, L 16 through p. 8, L 6.

to the expansion of infrastructure for the purpose of economic development, including infrastructure and equipment associated with alternative motor vehicle transportation fuel, the statute is silent with respect to the manner in which a regulated utility is permitted to operate in order to qualify for alternative regulatory treatment.[21]

Piedmont asserts that § 65-5-103(d)(3)(A) permits the proposed cross-subsidy.[22] Both the TFCA and the CAPD maintain that § 65-5-103(d)(3)(A) does not on its face and via its plain language authorize Piedmont's cross-subsidy proposal. For the Authority to endorse Piedmont's blanket, unsupported assertion that this statute endorses a cross-subsidy such as that proposed herein by Piedmont, the Authority would have to over-reach and thereby usurp the role of the Tennessee General Assembly. With respect to whether it was intended to allow the type of cross-subsidization proposed by Piedmont, the statute is, at best, ambiguous.

2. In light of the Ambiguity, the Authority Should Resort to the Legislative History of § 65-5-103(d)

Tennessee courts have relied on legislative history for statutory interpretation when a statute's language is unclear, subject to multiple interpretations, or is otherwise undefined in the statute. A review of case law reveals that courts will go beyond the plain language of the statute, including a review of the statute's legislative history, when parties provide conflicting reasonable interpretations of the statute's meaning.[23]

TFCA agrees that Tenn. Code Ann. § 65-5-103(d)(3)(A) authorizes, upon approval by the Authority, a mechanism to recover the operational expenses, capital costs or both related to the expansion of infrastructure and equipment associated with alternative motor vehicle

[21] *Pre-filed Testimony of TFCA Witness Jones* at p. 5, L15 through p. 6, L 2.
[22] *Pre-filed Rebuttal Testimony of Piedmont Witness Powers*, TRA Docket No. 14-00086 at pp. 4 – 8 (Dec. 22, 2014).
[23] *See BellSouth Telecoms. v. Greer*, 972 S.W.2d 663, 673-74 (Tenn. Ct. App. 1997).

transportations fuel for the purpose of economic development. TFCA also recognizes, consistent with the testimony of TFCA Witnesses Ron Jones and Dr. Scott Carr, and CAPD Witnesses William Novak and Dr. Chris Klein, that public utilities may, in appropriate circumstances, impose differing rates between and among customer classes. Even still, the type of cross-subsidization proposed here by Piedmont is easily distinguishable from carefully deliberated and approved subsidies established during general ratemaking. Like the CAPD, TFCA maintains that the statute does not expressly or impliedly countenance the proposed cross-subsidy.[24] Under the circumstances presented, including, but not limited to, the certain, substantial, and likely irrevocable impact on captive ratepayers,[25] the Authority must make every effort, and employ all permissible means, to ascertain the intent of the Tennessee General Assembly.

As recognized by Tennessee courts, "[t]he legislative process does not always produce precisely drawn laws. When the words of a statute are ambiguous or when it is just not clear what the legislature had in mind, courts may look beyond a statute's text for reliable guides to the statute's meaning."[26] In so doing, courts are not in search of the subjective beliefs of legislators or self-serving statements, as there is a distinction between what the legislature intended the law to mean and what various legislators, as individuals, hoped the consequences of the law would be. Instead, when they consult legislative history, courts pursue the intent of the General Assembly.[27]

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[24] *See, e.g., BellSouth Telecomms.*, 972 S.W.2d at 675 (The court noted that the newly enacted statute at issue did not specifically authorize or even mention adjustments for "unusual or abnormal financial occurrences.").

[25] *See, e.g., Piedmont's Responses to TRA Staff's Data Requests*, Response No. 6, TRA Docket No. 14-00086 (Oct. 23, 2014) ("To the extent this market does not develop or develops more slowly than it could, all of Piedmont's ratepayers will be harmed[.]").

[26] *BellSouth Telecomms.*, 972 S.W.2d at 673.

[27] *Id. See also, e.g., Standard Oil Co. v. State*, 117 Tenn. 618, 100 S.W. 705, 709-10 (Tenn. 1907) (*quoting Brown v. Hamlett*, 76 Tenn. 732, 8 Lea 732 (Tenn. 1882)) ("'The real intention will always prevail over the literal use of terms. Legislative acts fall within [this] rule, and it has been well said that a thing which is within the letter of a statute is not within the statute unless it be within the intention of the lawmakers.'").

In the context of utility regulation, the courts have often resorted to legislative history when the circumstances warranted.[28] Moreover, Tennessee courts have also recognized the role of non-legislators in developing legislative history.[29] Under the circumstances presented in this case, the Authority must review the relevant legislative history.

3. The Legislative History Clearly Reveals that the Legislature Did Not Intend § 65-5-103(d)(3)(A) to Endorse or Permit the Proposed Cross-Subsidy.

To be sure, Piedmont has expressed its rationale for its proposed cross-subsidization.[30] Nonetheless, and as noted earlier herein, the *specific* type of cross-subsidization proposed in this

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[28] *See, e.g., US LEC of Tenn., Inc. v. Tenn. Regulatory Auth.*, No. M2004-01417-COA-R12-CV, 2006 Tenn. App. LEXIS 243 (Tenn. Ct. App. Apr. 17, 2006) (In discussing the legislative history of the statute at issue, the court observed that the legislators' discussions in the committee and floor debates revealed that the legislators' main concern with regard to allowing municipal electric utilities to begin providing telecommunications services in competition with private businesses was the risk of cross-subsidization. In these discussions, the bill's sponsors emphasized that the telecommunications services would not be able to use "rate dollars" to subsidize their telecommunications business. Accordingly, the court concluded that the "subsidies" prohibited by the statute involved the shifting of the costs of providing telecommunications services from the telecommunications service customers to the electricity customers.); and *BellSouth Telecomms.*, 972 S.W.2d 663 (Tenn. Ct. App. 1997) (Reviewing a newly enacted statute, the court relied on legislative history to determine the appropriate definition of the word "audit.").

[29] *See, e.g., BellSouth Telecomms.*, 972 S.W.2d at 674 (staff memoranda); *Avenell v. Gibson*, No. E2004-01620-COA-R3-CV, 2005 Tenn. App. LEXIS 121 at *13-15 (Tenn. Ct. App. Feb. 28, 2005) (The Tennessee Court of Appeals relied upon the testimony of the then-President of the Tennessee Bar Association made during a legislative session in response to a question posed by a State Representative.); and *State v. Strode*, No. M2005-00906-CCA-R9-DD, 2006 Tenn. Crim. App. LEXIS 454 at *31-32 (Tenn. Ct. Crim. App. June 8, 2006) (non-legislator physicians).

[30] *Piedmont's Responses to TRA Staff's Data Requests*, Response No. 6. *See also Pre-filed Rebuttal Testimony of Piedmont Witness Powers*, pp. 4-8; and *Pre-filed Rebuttal Testimony of Piedmont Witness Valentine*, p. 3, L 8 through p. 4, L 9.

Surprisingly, Piedmont appears to go as far as contending that its proposal is not based on a cross-subsidization. *Pre-filed Rebuttal Testimony of Powers* at p. 6, L 14 through p. 8, L 18. Witness Powers states that it has not been shown that the costs of providing CNG services will not be fully covered by the revenue from such services. *Id.* at p. 6, LL 14-18. Further, Witness Powers refers to the arguments of the TFCA and the CAPD as "mere unsupported allegation of [cross-subsidization][.]" *Id.* at p. 8, LL 6-7. First, Piedmont has conceded that its shareholders are not funding any portion of its CNG operations. *Piedmont's Responses to Staff's Data Requests*, Response No. 7. Second, Piedmont's entire proposal is based on the need "for spreading any cost under-recovery for CNG service across Piedmont's total customer base." *Piedmont's Responses to TRA Staff's Data Requests*, Response No. 6. Third, Witness Powers has testified that its capital investment and costs in CNG infrastructure "are not fully offset by any incremental revenue associated with the increased investments[.]" *Pre-filed Testimony of Powers* at p. 3, LL 3-5, TRA Docket No. 14-00086 (Oct. 7, 2014). *See also Pre-filed Testimony of Piedmont Witness Kenneth Valentine* at p. 6, LL 12-13, TRA Docket No. 14-00086 (Oct. 7, 2014) ("[B]ut like most new investment the incremental cost of service associated with these facilities exceeds the initial revenues generated by these

case by Piedmont is very different from that present in general ratemaking. As explained in depth by TFCA Witness Jones, "[t]he cross-subsidization that is the centerpiece of Piedmont's Petition bears little resemblance to the thoughtful process and policy considerations that accompany Cost of Service deliberations that precede the allocation of the company's revenue requirement among rates classes."[31] In fact, "[t]he public policy objectives of regulators in establishing rate design, and the creation of subsidies and the [cross-subsidization] proposed in Piedmont's Petition bear little in common other than to say a 'subsidy' is present in rate design."[32] Moreover, as noted by TFCA Witness Dr. Carr, "Piedmont's current rate structure has been determined by the Authority to be just, reasonable, and in the public interest. However, the Authority has made no such determination regarding Piedmont's current proposal."[33]

As recognized by the court in *US LEC of Tenn. Inc.*,[34] an additional distinctive characteristic of the type of cross-subsidization proposed by Piedmont, as compared to general ratemaking subsidies, is that in the *Petition* the business benefiting from subsidization is doing so in a competitive market — the provision of CNG for the public consumption market. This distinction is critical because it is the presence of competitors (both active, emerging and potential competitors) that introduce the grave concerns regarding selectively provided benefits, vertical price squeeze, predatory pricing, barriers to entry, and anti-competitiveness, which are

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facilities."); and *Pre-filed Testimony of Valentine* at p.8, LL 6-9 ("[T]he costs of new capital investments and certain expenses . . . are not fully offset by the incremental revenues associated with the increased investments[.]"). Finally, Piedmont's responses to discovery also contradict Powers' surprising and late-arriving contention that Piedmont's proposal is not based on a cross-subsidization. *See, e.g., Piedmont's Responses to TFCA's First Set of Discovery Requests*, Responses Nos. 2 and 12, TRA Docket No. 14-00086 (Oct. 23, 2014).

[31] *Pre-filed Testimony of TFCA Witness Jones* at p. 19, LL 10-13.

[32] *Id.* at p. 19, LL 16-19.

[33] *Pre-filed Testimony of TFCA Witness Dr. Carr* at p. 9, LL 8-10.

[34] *See infra* n. 37.

addressed by both witnesses Dr. Carr and Dr. Klein.[35] In contrast, however, Piedmont's natural gas distribution customer classes are all within a regulated monopoly business (*i.e.*, Piedmont's natural gas distribution business). As such, misgivings about selectively provided benefits, vertical price squeeze, predatory pricing, barriers to entry, and anti-competitiveness simply do not arise in the regulated monopoly business.

Therefore, Piedmont's attempt to characterize its specific cross-subsidization proposal as being consistent with general ratemaking principles, and thus permissible under § 65-5-103(d)(3)(A), falls short. Under this analysis alone, the *Petition*, as concepted by Piedmont, should be denied irrespective of the legislative history.[36]

Notwithstanding Piedmont's misplaced reliance on general ratemaking principles, its rationale fails for yet another more compelling reason — it was rejected outright by the Tennessee General Assembly. As unambiguously addressed in Exhibit 1 to the pre-filed testimony of TFCA Witness Jones, Exhibit 2 to the pre-filed testimony of TFCA Witness Dr. Carr, Attachment WHN-1 to the pre-filed testimony of CAPD Witness Novak, and Attachment B to the pre-filed testimony of CAPD Witness Dr. Klein, coupled with their respective testimony on the same subject, the Tennessee General Assembly unequivocally defined a cross-subsidy with respect to § 65-5-103(d)(3)(A) as using captive natural gas ratepayer funds to pay for a regulated natural gas company's CNG operations for service to the public.[37] Further, the

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[35] *See Pre-filed Testimony of Dr. Carr* at pp. 11 – 19; *Pre-filed Testimony of Dr. Klein* at pp. 5 – 10; and *Piedmont Hearing Tr. 1A* at pp. 53-54. *See also CAPD's Response to Piedmont's Discovery Requests*, Response No. 2 (Dec. 23, 2014).

[36] *See, e.g., Pre-filed Testimony of TFCA Witness Jones* at p. 6, LL 6-12; p. 7, LL 1-5; p. 8, L19 through p. 9, L2.

[37] *See, c.f., US LEC of Tenn., Inc. v. Tenn. Regulatory Auth.*, 2006 Tenn. App. LEXIS 243 (In discussing the legislative history of the statute at issue, the court observed that the legislators' discussions in the committee and floor debates revealed that the legislators' main concern with regard to allowing municipal electric utilities to begin providing telecommunications services in competition with private businesses was the risk of cross-subsidization.

Tennessee General Assembly conspicuously declared its intention that such a cross-subsidy is not permissible in any alternative mechanism proposed under this section of the statute.[38] This cannot be credibly disputed.

Piedmont's lone attempt to dismiss the legislative history is, at best, not persuasive.[39] As the Authority well knows, any proceeding that has an impact upon the regulated rates of captive ratepayers — particularly a rate increase — is substantive. By asking for the approval to fund its CNG facilities and equipment for service to the general public with captive ratepayer funds, Piedmont is requesting the Tennessee Regulatory Authority to superimpose its will over the intent of the Tennessee General Assembly.[40] The Authority should refrain, deny the *Petition* and allow Piedmont the opportunity to refine its proposed alternative mechanism consistent with the intent of the legislature.

4. Piedmont's Contention that the Authority's Previous Approval of Rate Schedule 342 Rescues Its Cross-subsidization Proposal Is Not Well-Grounded

In its rebuttal testimony, Piedmont argues that its investment in CNG infrastructure "was very much dependent upon the *presumption* of rate base treatment for the investment."[41] Therefore, Piedmont maintains that it "should have the right to rely on Authority determinations

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In these discussions, the bill's sponsors emphasized that the telecommunications services would not be able to use "rate dollars" to subsidize their telecommunications business. Accordingly, the court concluded that the "subsidies" prohibited by the statute involved the shifting of the costs of providing telecommunications services from the telecommunications service customers to the electricity customers.).

[38] *See Pre-filed Testimony of TFCA Witness Jones* at p. 7, L9 through p. 8, L18; *Pre-filed Testimony of TFCA Witness Dr. Carr; Pre-filed Testimony of CAPD Witness Novak* at p. 12, LL 11-13; and *Pre-filed Testimony of CAPD Witness Dr. Klein* at p. 7, L11 through p. 8, L34.

[39] *Pre-filed Rebuttal Testimony of Piedmont's Witness Powers* at p. 12, LL 4-14.

[40] *See Planned Parenthood of Middle Tenn. v. Sunquist*, 38 S.W.3d 1, 7 (Tenn. 2000) ("We are not permitted to impose our policy views or to second-guess the General Assembly's policy judgments."); *Tennessee Dep't of Mental Health & Mental Retardation v. Allison*, 833 S.W.2d 82, 85 (Tenn. Ct. App. 1992) ("A department or agency of the State created by legislature cannot by the adoption of rules be permitted to thwart the will of the legislature . . . . Unelected officers of a department or agency cannot adopt rules to circumvent statutes passed by the legislature.").

[41] *Pre-filed Rebuttal Testimony of Powers* at p. 3, LL 13-15 (emphasis added).

as to the regulated or non-regulated nature of the services it offers unless and until that determination is changed on a prospective basis."[42] This argument is not persuasive for several reasons.

The first reason the foregoing argument should be rejected is based upon the testimony of CAPD Witness Novak. While Piedmont may have acted upon a "presumption," according to Witness Novak, "the TRA's approval of Rate Schedule 342 in the Company's last rate case involved no anticipated incremental rate base investment, no anticipated incremental operating expenses and no anticipated incremental revenue."[43] Additionally, as a witness in Piedmont's last rate case, Mr. Novak testified that his recollection "was that the Company proposal's [Rate Schedule 342] only included existing facilities for its own vehicle fleet that were already included in rate base and that the natural gas vehicle tariff would only be a small sideline business."[44] So, it appears that Piedmont's presumption may not have been warranted. In fact, the sheer dearth of information submitted by Piedmont in TRA Docket No. 11-00144 regarding its intentions with respect to Rate Schedule 342 would seem to corroborate Mr. Novak's testimony.[45]

Next, and notwithstanding Mr. Novak's testimony, it is axiomatic that the recovery from captive ratepayers of unannounced and unreviewed millions in CNG infrastructure by Piedmont certainly does not automatically follow the agency's approval of Rate Schedule 342. More is required.[46] At the time of the settlement of Piedmont's last rate case, § 65-5-103(d)(3)(A) did

[42] *Id.* at p. 22, LL 21-22 through p. 4, LL 1-2 (emphasis omitted).
[43] *Pre-filed Testimony of CAPD Witness Novak* at p. 8, LL 13-15 (emphasis omitted).
[44] *Id.* at p. 8, LL 16-19.
[45] *See CAPD's Responses to Piedmont's Discovery Requests*, Response No. 4 (Dec. 23, 2014).
[46] *See, e.g., Tennessee Am. Water Co.*, 2011 Tenn. App. LEXIS 51 at *2 (If a regulated utility "wants to implement a rate increase due to increased expenses or investments . . . it is required to file a revision to the existing tariffs and a petition asking TRA to approve the revision to the existing rates.").

not exist. So, at best, going forward from the time that Rate Schedule 342 was approved, Piedmont would have had to anticipate undergoing additional regulatory scrutiny before the Authority in a general rate case setting to justify any such CNG infrastructure investment before any regulatory recovery would have been permitted. Any presumptuous action by Piedmont before such Authority review rests solely on its shareholders until such time as the Authority determines otherwise. If Piedmont desired more regulatory certainty before making any such CNG infrastructure investments for service to the public, Piedmont certainly could have easily raised the issue with the Authority in TRA Docket No. 11-00144. Doing so would have eliminated Piedmont's need to presume.

The third reason that Piedmont's presumption should not sway the Authority is simply because presumptions cannot override state law. As plainly demonstrated above, § 65-5-103(d)(3)(A) does not permit a mechanism to recover the operational expenses, capital costs or both related to the expansion of infrastructure and equipment associated with the provision of CNG to the public by a regulated gas company for the purpose of economic development from regulated ratepayer funds.

Finally, there is yet another reason that further undermines Piedmont's assertion here. Assuming solely for the purposes of Piedmont's assertion that the Authority might find it necessary to review its actions in TRA Docket No. 11-00144 with respect to Rate Schedule 342, it is not prevented from doing so if justifiable grounds exist. Now fully abreast of Piedmont's

intentions with respect to Rate Schedule 342, the agency is not without the discretion to review its previous actions if appropriate circumstances warrant.[47]

B. Under the Second Prong of Review, the Petition Must Satisfy the Public Interest Standard.

1. Piedmont Has Failed to Show That the Petition Is In the Public Interest as Required By § 65-5-103(d).

On August 29, 2014, Piedmont filed the *Petition* pursuant to § 65-5-103(d) and seeks to recover approximately $9.3 million in incurred or future costs[48] associated with the certain facilities owned and operated by the Petitioner, which offers or will offer CNG as a fuel for motor vehicles.[49]

For the *Petition* to be permissible, it must be found to be in the public interest.[50] The second prong of review under § 65-5-103(d)(3) requires a finding that *both* the costs and expenses sought to be recovered *and* the rate mechanism proposed in the *Petition* for such recovery be "in the public interest."[51]

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[47] *See, e.g., United Cities Gas Co. v. Tennessee Public Serv. Com'n*, 789 S.W. 2d 256, 259 (Tenn. 1990) (*citing Public Service Commission v. General Telephone Company, etc.*, 555 S.W.2d 395 (Tenn. 1977)) ("[T]he 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.").

[48] Certain of the costs sought to be recovered by Piedmont were incurred prior to the effective date of Tenn. Code Ann. § 65-5-103(d). From March 2012 to June 2014 the Petitioner spent $4.7 million with respect to CNG fueling facilities. *Petition* at ¶ 8. It is perhaps noteworthy that section 5(a) of the Natural Gas Act, 15 U.S.C. § 717d(a) (1976), has been construed as limiting a natural gas utility's pursuit of retroactivity. *See, e. g., FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 618, 64 S.Ct. 281, 295, 88 L.Ed. 333 (1944); and *City of Piqua v. FERC*, 610 F.2d 950, 954 (D.C. Cir.1979).

[49] *Petition* at ¶ 5.

[50] "[T]he words 'public interest' in a regulatory statute . . . take meaning from the purposes of the regulatory legislation." *Am. Paper Inst. v. Am. Elec. Power Serv. Corp.*, 461 U.S. 402, 417 (1983) (*quoting NAACP v. FPC*, 425 U.S. 662, 669 (1976)) (alterations in original). For the legislative purposes of Tenn. Code Ann. § 65-5-103, see Section II.B.3 *supra*.

[51] Tennessee Code Annotated § 65-5-103(d)(3) (2014) states:

> (A) A public utility may request and the authority may authorize a mechanism to cover the operational expenses, capital costs or both related to the expansion of infrastructure for the purpose of economic development, *if such expenses or costs are found by the authority to be in the public*

As noted by TFCA Witness Jones, the public interest test is fluid yet must be applied by the Authority to adhere to legislative intent and consistent with the regulatory compact.[52] As long as the outcome of its review is just and reasonable, the Authority has broad discretion in conducting the required public interest review.[53] Hence, it is well-settled that in performing a public interest analysis, the Authority is not necessarily bound by a previous approach taken in another case, as other specific matters before it, along with their respective particular circumstances, may require a broader and deeper public interest analysis than that conducted in previous matters with distinguishable issues and varying potential impact upon the public good.

The record in this case is without sufficient evidence provided by Piedmont to allow for a finding that the infrastructure rider recovery mechanism found in the *Petition* is in the public interest. In this respect, too, Piedmont has failed its burden of proof.

> *interest*. Expansion of economic development infrastructure may include, but is not limited to, the following:
>
> (i) Infrastructure and equipment associated with alternative motor vehicle fuel;
>
> (ii) Infrastructure and equipment associated with combined heat and power installations in industrial or commercial sites; and
>
> (iii) Infrastructure that will provide opportunities for economic development benefits in the area to be directly served by the infrastructure.
>
> (B) The authority shall grant recovery and shall authorize a separate rate recovery mechanism or adjust rates to recover operational expenses, capital costs or both associated with the investment in such economic development facilities, including the return on economic development investments at the rate of return approved by the authority at the public utility's most recent general rate case pursuant to §§ 65-5-101 and 65-1-103(a), *upon a finding that such mechanism or adjustment is in the public interest* (emphasis added).

[52] *Pre-filed Testimony of TFCA Witness Jones* at p. 13, L 10 through p. 14, L 15.

[53] *Tennessee Am. Water Co.*, 2011 Tenn. App. LEXIS 51 at *46 (The court noted that there is no particular approach, precise method or formula that must be followed by the Authority.). *See also id.* at *64 (In order to carry out its mandate from the legislature, the Authority "must be able to draw on its own internal sources of knowledge and experience.").

Piedmont makes much of the environmental, economic development and other benefits of CNG as an alternative fuel for motor vehicles, and in support thereof, submitted certain information, reports and indications of public policy support for CNG as a motor fuel. By way of example, Piedmont relies upon a Memorandum of Understanding[54] signed by Governor Haslam in March 2013, which encourages "automobile manufacturers . . . to develop a functional and affordable original equipment manufacturer (OEM) fleet natural gas vehicle" and for states to purchase such vehicles for their fleets. While the MOU, the Energy Independence Act of 2013[55] and other sources cited by Piedmont work to validate certain benefits of alternative motor vehicle fuels generally, these sources do not make the case as to why the specific rate recovery mechanism proposed in the *Petition* is in the public interest.[56] In fact, the benefits cited by Piedmont are benefits attributable to the use of compressed natural gas as an alternative motor vehicle fuel and are not the beneficial characteristics of the rate recovery mechanism proposed by Piedmont. Piedmont has not demonstrated (nor is there any evidence in the record) that the

[54] Memorandum of Understanding from Governors of Oklahoma, Colorado, Wyoming, Pennsylvania, Utah, Maine, New Mexico, West Virginia, Kentucky, Texas, Ohio, Mississippi, Louisiana, Arkansas, Virginia, and Tennessee (signed by Gov. Haslam on March 22, 2013).

[55] *Petition* at ¶ 7.

[56] In his rebuttal testimony, Piedmont witness Kenneth Valentine references a paper published by Ken Costello of the National Regulatory Research Institute titled "Natural Gas Vehicles: What State Commissions Should Know and Ask" which was filed as Exhibit KTV-3 to such testimony (the "NRRI Paper"). *Pre-filed Rebuttal Testimony of Piedmont Witness Valentine* at p.10. However, the NRRI Paper does not stand for the proposition that the rate mechanism proposed in the *Petition* itself is in the public interest. Read closely, Mr. Valentine's word in reference to the NRRI Paper are carefully chosen, reading that "state commissions should foster the [natural gas vehicle] market – meaning allow natural gas utilities or their affiliates to charge ratepayers for investing in and operating infrastructure necessary for . . . [natural gas vehicles] – if and when they determine that this action would coincide with the public interest." (Emphasis added). As argued by witnessed for the TFCA and CAPD, there has been no demonstration of public interest in the *Petition*. The "if and when" has not occurred or been recognized. To the contrary, as shown by witnesses for the TFCA and the CAPD, the *Petition* is not in the public interest.

To be sure, one must read and evaluate the NRRI Paper in its entirety, not piecemeal, selecting a single quote or sentence. Indeed, much of what the NRRI Paper has to say on this subject supports the position of TFCA in this proceeding. For example, the NRRI Paper states that "[a]n 'uneven playing field' in favor of the utility can discourage entry by third parties and forestall the time that refueling stations could compete with each other." NRRI Paper at p. 16, n. 40. The NRRI Paper further explains that "[i]f the utility-owned station receives ratepayer funding and other regulatory-approved advantages, other entities might decide not to compete. The outcome would likely result in a smaller number of refueling stations in the long term." *Id.* at p. 16, n. 42.

approval of Piedmont's *Petition* is necessary for any of these benefits to take place; that is, there is no evidence that the benefits of using compressed natural gas as an alternative motor vehicle fuel would not come into fruition through other market-driven avenues.

There is little dispute about certain general environmental, economic development and other benefits of alternative motor vehicle fuels, including CNG.[57] What is disputed is whether the rate recovery mechanism proposed in Piedmont's *Petition* is in the public interest, as required by § 65-5-103(d)(3). A detailed and through review of the record reveals that Piedmont provides little to show that the specific recovery mechanism it proposes is in the public interest. On this point, Piedmont Witness Powers offers only the mere conclusory statement that "the proposed rider mechanism . . . is in the public interest."[58] Such unsubstantiated assertions void of reasoning, supporting studies and analyses with respect to the specific infrastructure rider proposed by Piedmont cannot credibly support a finding of being in the public interest.

2. The Petition Is Anticompetitive and Not In the Public Interest.

The Authority is empowered to exercise sound regulatory judgment and discretion in determining rate adjustment requests such as the present *Petition*.[59] In considering whether a rate adjustment or recovery mechanism is in the public interest, the Authority should balance several factors, including the competitive fairness of the proposed rate or mechanism.[60]

While Piedmont has failed to demonstrate that the specific rate recovery mechanism proposed in the *Petition* is in the public interest, the testimonies of TFCA Witnesses Jones and Dr. Carr and CAPD Witnesses Novak and Dr. Klein prove that Piedmont's *Petition* is *not* in the

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[57] *Piedmont Hearing Tr. 1B* at p. 74, l. 9-19 (Hearing Testimony of TFCA Witness Dr. Scott Carr).
[58] *Pre-filed Testimony of Piedmont Witness Powers* at p. 6, LL 12-13.
[59] *CF Industries*, 599 S.W.2d at 543.
[60] *See, c.f., Gulf States Utilities Co. v. Federal Power Comm'n.*, 411 U.S. 747, 762 (1973) ("the [Federal Power Commission] must consider anticompetitive aspects of a security issue . . . ."); and *Bellsouth BSE v. Tenn. Regulatory Auth.*, No. M2000-00868-COA-R12-CV, 2003 Tenn. App. LEXIS 123, at *34 (Tenn. Ct. App. Feb. 18, 2003) ("[F]ederal law places a duty on the TRA to promote or insure competition in the provision of telecommunication services.").

public interest for, among others, the two following reasons: (1) the effect of the rate mechanism is anticompetitive, including through the creation of an impermissible cross-subsidy and (2) the rate mechanism does not comport with relevant aspects of state law.

Competitive fairness of the *Petition* is a factor which the Authority should properly consider in its evaluation.[61] TFCA Witness Dr. Carr and CAPD Witness Dr. Klein provided testimony as to the competitive unfairness and other anticompetitive aspects of the *Petition*. In his pre-filed testimony and at the hearing held on January 12, 2015, Dr. Carr identified the following negative competition-related consequences of the *Petition*:[62]

a. *The Competitive CNG Market*. Piedmont's business lines are two distinct businesses with different competitive characteristics.[63] Unlike Piedmont's natural gas distribution business which operates as a public utility monopoly, the CNG motor vehicle fuel market is competitive with a large number of active or potential competitors within the CNG fueling business.[64] Piedmont has specifically identified Trillium and Waste Management as two competitors already operating CNG fueling facilities in the Nashville, Tennessee area.[65] As for potential competitors, Piedmont has indicated that the field is wide open, stating that "[a]nyone could be a potential competitor."[66] The development of the CNG business thus far has occurred in the absence of the type of relief requested in the *Petition*; it is reasonable to assume that the CNG fueling business will continue to so develop.[67] And, there is no evidence in the record to

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[61] *See Gulf States Utilities*, 411 U.S. at 762; *Bellsouth BSE*, 2003 Tenn. App. LEXIS 123, at *34.
[62] *Piedmont Hearing Tr. IB* at pp. 71-74 (Hearing Testimony of TFCA witness Dr. Scott Carr); *Pre-filed Testimony of TFCA Witness Dr. Carr* at p. 6, L 2 through p. 7, L2.
[63] *Pre-filed Testimony of TFCA Witness Dr. Carr* at 3, LL 1-9; p. 4, LL 2-3; and p. 5, L 17 through p. 7, L 10...
[64] *Id.*
[65] *Piedmont's Responses to TFCA's Discovery Requests*, Response No. 7, TRA Docket No. 14-00086 (Oct . 14, 2014). *See also Pre-filed Rebuttal Testimony of Piedmont Witness Powers* at p. 9.
[66] *Piedmont's Respones to TFCA's Discovery Requests*, Response No. 7, TRA Docket No. 14-00086 (Oct. 14, 2014).
[67] In fact, Exhibit KTV-4 filed with Piedmont Witness Ken Valentine's rebuttal testimony identifies other competitors and potential competitors in the CNG fueling business, including truck stop operators Pilot/Flying J,

the contrary. On the other hand, the record shows that Piedmont's alternative rate mechanism, as proposed, would actually distort the market and harm competition in the CNG motor fuel market in Tennessee.

b. *Improper Cross-Subsidy*. Piedmont's alternative rate mechanism would create an improper cross-subsidy. That is, captive customers of Piedmont's natural gas distribution business would subsidize, by way of increased prices, Piedmont's compressed natural gas vehicle fueling business.[68] This is an impermissible subsidy under existing state law as embodied in § 65-5-103 and, accordingly, not in the public interest.

c. *Selective Benefits to Piedmont*. Given Piedmont's vertical integration, the financial benefits proposed by Piedmont would accrue only to Piedmont, and not to any other participants or competitors in the CNG fueling business.[69]

d. *Predatory Pricing*. The financial benefits selectively enjoyed by Piedmont through the *Petition* would provide Piedmont with a cost advantage, enabling Piedmont to engage in predatory pricing.[70] Predatory pricing is inimical to the *Petition* for several reasons, including its anticompetitive consequences and its conflict with other state laws governing Piedmont's request. These conflicts with other state laws are discussed below.

Love's and TravelCenters of America and convenience store companies Kwik Trip and OnCue Express. In considering the development of markets it is proper to consider not only current market participants, but potential competitors as well. *TFCA's Responses to Piedmont's Discovery Requests*, Response No. 4, TRA Docket No. 14-00086 (Jan. 5, 2015).

[68] *See also* Section II.B.3 *supra* as to Piedmont's proposed cross-subsidy.

[69] *See Pre-filed Testimony of TFCA Witness Dr. Carr* at p. 12, LL 3-9. For competitors and potential competitors in the CNG fueling market, *see* footnote no. 66 *supra*.

[70] "Predatory pricing occurs when a firm sets its prices below its costs of providing goods and services; such low pricing lures customers away from the firm's competitors thereby rendering the competitors unprofitable. As a result, predatory pricing removes competitors from a market (because the competitors find themselves to be unprofitable) or keeps potential competitors from entering the market (because it becomes impossible for would-be competitors to be profitable). In both of these cases, predatory pricing reduces the number of competitors in the market and is thus anticompetitive." *Pre-filed Testimony of TFCA Witness Dr. Carr* at p. 14, L 19 through p. 15, L 5.

With respect to sales of other motor vehicle fuels, the Tennessee General Assembly has acknowledged the detrimental effects of predatory pricing, stating that:

> "Subsidized pricing is inherently unfair and destructive to, and reduces competition in, the motor fuel marketing industry, and is a form of predatory pricing. . . . . [A] . . . purpose of this part is to prevent and eliminate subsidized pricing of petroleum and related products."[71]

As noted by TFCA Witness Jones, Piedmont's *Petition* runs afoul of several state laws, including Tenn. Code Ann. §§ 65-5-104 (unjust rate), 65-4-115 (unjust practices) and 65-4-122 (unjust discrimination).[72] By way of example, Piedmont's proposal, if approved, would, among other things, violate Tenn. Code Ann. § 65-4-115, which prohibits public utilities from engaging in unjust, unduly preferential, or discriminatory actions, by allowing Piedmont to avoid funding costs that its competitors and potential competitors cannot avoid—namely, the cost of its CNG motor fuel infrastructure. In addition, Piedmont's proposed Rate Schedules 342 and 343 would violate Tenn. Code Ann. § 65-4-122, which prohibits utility services from charging different customers different rates, by unfairly and in a legally inappropriate fashion singling out certain customers for price discounts. As thoughtfully explained by TFCA Witness Jones, the direct and harmful prohibited conflicts between the *Petition* and long-established state law and regulatory rules and policies alone cause Piedmont's proposal to not advance the public good and thereby fail the public interest examination.[73]

e. *Barrier to Entry*. If granted, the *Petition* would afford Piedmont financial advantages unavailable to its competitors and potential entrants into the natural gas fueling business. That is, Piedmont's construction costs would be lower as those costs would be borne

[71] Tenn. Code Ann. § 47-25-603 (2014). *See also Pre-filed Testimony of TFCA Witness Dr. Carr* at p. 14, LL 13-16.
[72] *Pre-filed Testimony of TFCA Witness Jones* at pp. 10, L 9 through p. 11, L. 7; p. 17, LL 1-6; and p. 23, L 5 through p. 25, L 14.
[73] *See Piedmont Hearing Tr. 1A.*at pp. 60-63 (Hearing testimony of TFCA Witness Jones). It is crucially important to evaluate what Piedmont has actually proposed rather than evaluate Piedmont's interpretation of what it has proposed. Here, there is no statutory allowance or defense for Piedmont's proposal, and as presented in this docket, Piedmont's proposal is a violation of state law and not in the public interest.

by Piedmont's captive ratepayers, thus erecting a barrier to entry[74] to the CNG motor vehicle fuel market. An anticompetitive effect of this barrier to entry would be to decrease the number of participants in the CNG motor vehicle fuel business.[75]

Contrary to the premise forwarded by Piedmont for the adoption of the alternative rate mechanism, the combined effect of the anticompetitive features of the *Petition* is to inhibit the greater acceptance and use of CNG as a motor fuel alternative through disruption of the competitive landscape in favor of Piedmont. As Dr. Carr testified "[t]he public interest would be served by a CNG fueling market with robust competition between multiple retail CNG suppliers[.]"[76]

In considering the testimonies of Dr. Carr and Dr. Klein as to the anticompetitive consequences of the *Petition*, the Authority may find guidance in a tenet of antitrust or competition law that allows for a tribunal, like the Authority, to consider the future effects of a proposed action or course of conduct. For example, in considering the potential effects of a proposed merger, the United States Supreme Court has held for some time that Section 7 of the Clayton Act was intended to stop incipient threats to competition.[77] The analysis is necessarily

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[74] Nobel Prize Laureate George Stigler provides the following definition of a barrier to entry: "A barrier to entry may be defined as a cost of producing (at some or every rate of output) which must be borne by a firm which seeks to enter an industry but is not borne by firms already in the industry." *TFCA's Responses to Piedmont's Discovery Requests*, Response No. 4, TRA Docket No. 14-00086 (Jan. 6, 2015).

[75] In rebuttal testimony, Piedmont Witness Powers concedes the likelihood of this anticompetitive effect, stating, "[t]he existence of a regulated utility CNG sales service may have the potential to be unfair and/or a barrier to entry to third-parties that desire to sell CNG as a motor vehicle fuel in competition with Piedmont." *Pre-filed Rebuttal Testimony of Piedmont Witness Powers* at p. 8, LL 14 – 16 (emphasis in original).

[76] *Piedmont Hearing Tr. 1B* at p. 74.

[77] *See U.S. v. Penn-Olin Chem. Co.*, 378 U.S. 158, 171 (1964), *aff'd*, 389 U.S. 308 (1967). Generally, Section 7 of the Clayton Act addresses a merger's impact on future competition and therefore a merger may be impermissible even in cases where its predicted anticompetitive effect is not certain. *See., e.g., U.S. v. Philadelphia Nat'l Bank*, 374 U.S. 321, 367 (1963) (one purpose of Section 7 is "to arrest the trend toward concentration, the tendency to monopoly, before the consumer's alternatives disappear[ ] through merger."); and *Brown Shoe Co. v. U.S.*, 370 U.S. 294, 323 (1962) ("Congress used the words 'may be substantially to lessen competition,' . . . to indicate that its concern was with probabilities, not certainties.").

forward-looking, as are necessarily a host of TRA decisions.[78] The TFCA submits that the Authority's analysis in this docket must also be forward-looking as to the effects on the development of the CNG motor vehicle fuel market and on Piedmont's captive ratepayers who being asked to fully shoulder the financial costs of Piedmont's expansion into, and operation in, the CNG motor vehicle fuel business.

For the above reasons, and as supported in the record, the *Petition's* anticompetitive effects render it not in the public interest.

III.

CONCLUSION

For the foregoing reasons, and consistent with the evidentiary record, TFCA respectfully requests that the Petition of Piedmont Natural Gas Company, Inc. in the above-captioned

[78] *Tennessee Am. Water Co.*, 2011 Tenn. App. LEXIS 51 at 38 ("Rates are set for the future, and the estimated effect of all reasonably expected changes affecting the rate of return . . . must be taken into consideration in the establishment of rates. . . . Thus, a rate should be reasonable not only when it is first established but also for a reasonable time thereafter") (citations omitted).

consolidated docket be denied and that Rate Schedule 342 be terminated.[79]

Respectfully submitted this 22nd day of January, 2015.

BUTLER SNOW LLP

By:_____

Melvin J. Malone
Michael W. Sheridan
Valeria E. Gomez
The Pinnacle at Symphony Place
150 3rd Avenue South, Suite 1600
Nashville, TN 37201
(615) 651-6705 (Office Telephone)
(615) 651-6701 (Facsimile)
melvin.malone@butlersnow.com
michael.sheridan@butlersnow.com
valeria.gomez@butlersnow.com

Counsel for Tennessee Fuel and Convenience Store Association

[79] *Pre-filed Testimony of TFCA Witness Jones* at p. 4, LL 10-11.

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served via U.S. Mail or electronic mail upon:

Jane Lewis-Raymond, Esq.
Senior Vice President and Chief Legal, Compliance,
and External Relations Officer
Piedmont Natural Gas Company, Inc.
P.O. Box 33068
Charlotte, NC 28233
Jane.Lewis-Raymond@piedmontng.com

R. Dale Grimes, Esq.
Bass, Berry & Sims PLC
150 Third Avenue South, Suite 2800
Nashville, TN 37201
dgrimes@bassberry.com

James H. Jeffries, IV, Esq.
Moore & Van Allen PLLC
100 North Tryon Street, Suite 4700
Charlotte, NC 28202-4003
jimjeffries@mvalaw.com

Wayne Irvin, Esq.
Assistant Attorney General
Office of the Tennessee Attorney General
Consumer Advocate and Protection Division
P.O. Box 20207
Nashville, TN 37202-0207
Wayne.Irvin@ag.tn.gov

Vance Broemel
Consumer Advocate and Protection Division
Office of the Attorney General
P.O. Box 20207
Nashville, TN 37202
Vance.Broemel@ag.tn.gov

This the 22nd day of January, 2015.

Melvin J. Malone

Neutral
As of: January 22, 2015 2:56 PM EST

Tenn. Am. Water Co. v. Tenn. Regulatory Auth.

Court of Appeals of Tennessee, at Nashville

August 30, 2010, Session; January 28, 2011, Filed

No. M2009-00553-COA-R12-CV

Reporter
2011 Tenn. App. LEXIS 51; 2011 WL 334678

TENNESSEE AMERICAN WATER COMPANY, v. THE TENNESSEE REGULATORY AUTHORITY, et al.

Subsequent History: Appeal denied by, Motion denied by *Tenn. Am. Water Co. v. Tenn. Regulatory Auth., 2011 Tenn. LEXIS 550 (Tenn., May 25, 2011)*

Prior History: [*1] *Tenn. R. App. P.3* Appeal as of Right; Judgment of the Tennessee Regulatory Authority Affirmed in Part and Reversed in Part. Appeal from the Tennessee Regulatory Authority. No. 08-00039.

Disposition: Judgment of the Tennessee Regulatory Authority Affirmed in Part and Reversed in Part.

Core Terms

audit, rate case, management fee, expenses, final order, methodology, Consumer, forecast, Company's, attrition, costs, rates, service company, services, customers, test period, requirements, utilized, projected, normalization, cases, material evidence, allocated, prudent, usage, contends, residential, financial statement, rate-making, calculating

Case Summary

Overview

Appellant water company petitioned appellee regulatory authority to approve a revision to the existing rates it charges its customers for water. The regulatory authority authorized a revision in the existing tariffs but made several rulings adverse to the water company. The appellate court affirmed all rulings except one that only allowed the water company to recover one-half of the rate case expenses since that ruling was arbitrary. The authority was required to pay the full amount of the rate case expenses claim.

Outcome

Judgment affirmed in part and reversed in part.

LexisNexis® Headnotes

Energy & Utilities Law > Utility Companies > Rates > General Overview

HN1 A public utility is required to obtain approval from the Tennessee Regulatory Authority before implementing an increase in the rates it charges its customers, *Tenn. Code Ann. § 65-5-103(a)*. The rates must be set forth in tariffs filed with and approved by regulatory authority and the utility can only charge the rates set forth in a duly filed and effective tariff, *Tenn. Code Ann. § 65-5-102*; Tenn. Comp. R. & Regs. 1220-4-1-.03. If the utility wants to implement a rate increase due to increased expenses or investments or decreased revenues or for any other reason, it is required to file a revision to the existing tariffs and a petition asking the regulatory authority to approve the revision to the existing rates, *Tenn. Code Ann. § 65-5-103*; Tenn. Comp. R. & Reg. 1220-4-1-.03 to 1220-4-1-.06.

Administrative Law > Judicial Review > Standards of Review > General Overview

Administrative Law > Judicial Review > Standards of Review > Abuse of Discretion

Administrative Law > Judicial Review > Standards of Review > Arbitrary & Capricious Standard of Review

Administrative Law > Judicial Review > Standards of Review > Substantial Evidence

Energy & Utilities Law > Utility Companies > Rates > General Overview

HN2 Appellate review of the Tennessee Regulatory Authority's actions is confined to the record, *Tenn. Code Ann. §4-5-322(g)*. The standard of review to be employed is provided by *Tenn. Code Ann. §4-5-322(h)*.

Administrative Law > Judicial Review > Standards of Review > General Overview

Administrative Law > Judicial Review > Standards of Review > Abuse of Discretion

Administrative Law > Judicial Review > Standards of Review > Arbitrary & Capricious Standard of Review

Administrative Law > Judicial Review > Standards of Review > Substantial Evidence

Energy & Utilities Law > Utility Companies > Rates > General Overview

HN3 See *Tenn. Code Ann. § 4-5-322(h)*.

Administrative Law > Judicial Review > Standards of Review > General Overview

Administrative Law > Judicial Review > Standards of Review > Abuse of Discretion

Administrative Law > Judicial Review > Standards of Review > Arbitrary & Capricious Standard of Review

Administrative Law > Judicial Review > Standards of Review > Substantial Evidence

Energy & Utilities Law > Utility Companies > Rates > General Overview

HN4 Appellate court review of the Tennessee Regulatory Authority's (TRA) actions is for the very limited purpose of determining whether the Commission has acted arbitrarily, or in excess of jurisdiction, or otherwise unlawfully. Review is restricted to the record and the TRA's finding may not be reversed or modified unless arbitrary or capricious or characterized by an abuse, or clearly unwarranted exercise of discretion and must stand if supported by substantial and material evidence. The criteria by which the TRA should be guided have received only generalized comments in the reported decisions. This is proper because the courts are playing a limited role in reviewing actions which essentially are legislative in character. Rate making is not a judicial function and appellate courts accord the TRA great deference in reviewing its decisions. On fixing rates in general, courts have spoken in terms of what is just and reasonable under the proven circumstances, of regard to all relevant facts and to a rate in the zone of reasonableness.

Administrative Law > Judicial Review > Standards of Review > General Overview

Energy & Utilities Law > Utility Companies > Rates > General Overview

HN5 An appellate court will not disturb a reasonable decision of an agency with expertise, experience and knowledge in the appropriate field. There is also a presumption that the rates so established are correct and any party who attacks the Commission's findings has the burden of proving that they are illegal or unjust and unreasonable. When the rates set by the agency are attacked there is a heavy burden on those who attacked them to make a convincing showing that the rates are invalid.

Administrative Law > Judicial Review > Standards of Review > Arbitrary & Capricious Standard of Review

HN6 The standards of review in *Tenn. Code Ann. § 4-5-322(h)(4)* and *(h)(5)* are narrower than the standard of review normally applicable to other civil cases. They are also related but are not synonymous. Agency decisions not supported by substantial and material evidence are arbitrary and capricious. However, agency decisions with adequate evidentiary support may still be arbitrary and capricious if caused by a clear error in judgment. A reviewing court should not apply *§ 4-5-322(h)(4)*'s arbitrary and capricious standard of review mechanically. In its broadest sense, the standard requires the court to determine whether the administrative agency has made a clear error in judgment. An arbitrary decision is one that is not based on any course of reasoning or exercise of judgment, or one that disregards the facts or circumstances of the case without some basis that would lead a reasonable person to reach the same conclusion.

Administrative Law > Judicial Review > Standards of Review > Substantial Evidence

HN7 A reviewing court should not apply *Tenn. Code Ann. § 4-5-322(h)(5)*'s substantial and material evidence test mechanically. Instead, the court should review the record carefully to determine whether the administrative agency's decision is supported by such relevant evidence as a rational mind might accept to support a rational conclusion. The court need not reweigh the evidence, and the agency's decision need not be supported by a preponderance of the evidence. The evidence will be sufficient if it furnishes a reasonably sound factual basis for the decision being reviewed. The substantial and material evidence standard has been described as requiring something less than a preponderance of the evidence but more than a scintilla or glimmer.

Administrative Law > Judicial Review > Standards of Review > De Novo Standard of Review

Energy & Utilities Law > Utility Companies > Rates > General Overview

Evidence > Inferences & Presumptions > Presumptions

HN8 The Tennessee Regulatory Authority's conclusions of law are subject to a de novo review without a presumption of correctness. A fundamental tenet of the legislative function of ratemaking requires the balancing of the utility's interest

in performing its public duties and earning a reasonable return on investment. Rates are set for the future, and the estimated effect of all reasonably expected changes affecting the rate of return, including increases in expenses and investments, must be taken into consideration in the establishment of a rate. Thus, a rate should be reasonable not only when it is first established but also for a reasonable time thereafter.

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HN9 A necessary component of utility ratemaking is the authority of the Tennessee Regulatory Authority to "fix" just and reasonable rates, not simply to approve or deny a utility's request. The legislature has recognized that a public utility may set its own rates, subject to the power to suspend the rates for a certain period of time while it makes the utility prove that the rates are just and reasonable. If the utility fails to carry that burden, the agency has the additional authority to fix rates that meet the just and reasonable criteria. In ratemaking proceedings, the burden of showing the proposed rates are just and reasonable rests with the utility seeking the change in rates, *Tenn. Code Ann. § 65-5-103(a)*. 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.

Energy & Utilities Law > Utility Companies > Rates > General Overview

HN10 The Tennessee Regulatory Authority (TRA) has the discretion to utilize an historical test period, a forecast period, a combination of these where necessary, or any other accepted method of rate making necessary to give a fair rate of return. There is no statutory nor decisional law that specifies any particular approach that must be followed by the Commission. Fundamentally, the establishment of just and reasonable rates is a value judgment to be made by the Commission in the exercise of its sound regulatory judgment and discretion. Accordingly, neither the courts nor the legislature has established any precise method or formula in setting rates, and the TRA is not bound by any particular approach. The TRA is not limited to adopting one specific test period in order to make known and measurable adjustments to produce just and reasonable rates. There is simply no requirement that the TRA utilize the specific test period proposed by a public utility.

Administrative Law > Judicial Review > Standards of Review > Arbitrary & Capricious Standard of Review

HN11 In its broadest sense, the arbitrary and capricious standard requires an appellate court to determine whether the administrative agency has made a clear error in judgment or a decision not based on any course of reasoning or exercise in judgment.

Administrative Law > Judicial Review > Standards of Review > Arbitrary & Capricious Standard of Review

HN12 The arbitrary and capricious standard requires an appellate court to determine whether the administrative agency has made a clear error in judgment or a decision not based on any course of reasoning or exercise in judgment.

Administrative Law > Judicial Review > Standards of Review > General Overview

Energy & Utilities Law > Utility Companies > Rates > General Overview

HN13 The courts are playing a limited role in reviewing actions which essentially are legislative in character. Rate making is not a judicial function and courts accord the Commission great deference in reviewing its decisions. On fixing rates in general courts have spoken in terms of what is just and reasonable under the proven circumstances, of regard to all relevant facts and to a rate in the zone of reasonableness. The Uniform Administrative Procedures Act authorizes the agency to take notice of generally recognized technical and scientific facts within the agency's specialized knowledge, and in the evaluation of evidence the agency is specifically authorized to utilize its experience, technical competence, and specialized knowledge, Tenn. Code Ann. § 4-5-1097.

Energy & Utilities Law > Utility Companies > Rates > General Overview

HN14 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.

Administrative Law > Judicial Review > Reviewability > General Overview

Energy & Utilities Law > Utility Companies > Rates > General Overview

HN15 The impact of the Administrative Procedures Act on the review of the decisions made by state boards, commissions and agencies, including the Public Service Commission , is massive and it casts upon the Commission the heavy burden of a sound, reasoned, and judicious approach in the exercise of its jurisdiction. Neither the legislature nor the courts have established any precise formula or yardstick to guide the Commission. The process of setting rates is not required to follow any particular course, so long as the end result does not violate the just and reasonable requirement. The Commission is not bound by a single formula or a combination of formulas in fixing rates and none is exclusive or more favored than the others. There is no precise statutory or court announced basis for determining the justness or reasonableness of class rate level structures or relationships. Generally, rate making is the responsibility of a regulatory commission effectively exercising its discretion upon sufficient evidence before it.

Administrative Law > Judicial Review > Reviewability > General Overview

Energy & Utilities Law > Utility Companies > Rates > General Overview

HN16 It must be presumed that the members of the commission itself, with their supporting staff, have in their grasp practical knowledge in the field of utilities regulation not possessed by either the courts or laymen in general. The commission, in order to carry out its mandate from the legislature to establish just and reasonable rates, must be able to draw on its own internal sources of knowledge and experience. As with the legislature itself, it is assumed that it does so in each instance and that courts ought not to interfere unless it should clearly exceed its statutory powers.

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HN17 The Tennessee Regulatory Authority (TRA) is not required to follow a particular methodology it has used in the past as long as the methodology it chooses allows it to arrive a determination of a rate that is just and reasonable. Moreover, the TRA is not limited to considering just what is in the record as it may consider, in addition to the proof, recognized technical and scientific facts pertinent to the issue and may superimpose its own expertise, technical competence and specialized knowledge. The TRA is only required to use its regulatory judgment and exercise its discretion to decide what is a just and reasonable rate.

Counsel: R. Dale Grimes, Nashville, Tennessee, for the Appellant, Tennessee American Water Company.

J. Richard Collier, Kelly Cashman-Grams and Shilina B. Brown, Nashville, Tennessee, for the Appellee, Tennessee Regulatory Authority.

Robert E. Cooper, Jr., Attorney General and Reporter, Michael E. Moore, Solicitor General, and Ryan McGehee, Assistant Attorney General, Nashville, Tennessee, for the Appellee, Consumer Advocate and Protection Division of the Office of the Tennessee Attorney General.

Frederick L. Hitchcock, Harold L. North, Jr., Tom Greenholtz, Michael A. McMahan and Valerie L. Malueg, Chattanooga, Tennessee, for the Appellee, City of Chattanooga.

David C. Higney, Chattanooga, Tennessee, and Henry M. Walker, Nashville, Tennessee, for the Appellee, Chattanooga Manufacturers Association.

Judges: HERSCHEL PICKENS FRANKS, P.J., delivered the opinion of the Court, in which CHARLES D. SUSANO, JR., J., and. D. MICHAEL SWINEY, J., joined.

Opinion by: HERSCHEL [*2] PICKENS FRANKS

Opinion

The Tennessee American Water Company petitioned the Tennessee Regulatory Authority to approve a revision to the existing rates it charges its customers for water. The Authority authorized a revision in the existing tariffs but made several rulings adverse to the plaintiff. Plaintiff has appealed numerous issues. On appeal, we affirm the rulings of the Authority, except its ruling which only allowed plaintiff to recover one-half of the rate case expenses. We hold that ruling was arbitrary and we require the Authority to pay the full amount of the rate case expenses claim.

OPINION

Background

Appellant, Tennessee American Water Company (TAWC), is an investor-owned public utility that provides water service to residential, industrial, commercial and municipal

customers in the City of Chattanooga, Tennessee and area. It is a wholly owned subsidiary of American Water Works Company, Inc. (Parent Company). Parent Company is a holding company that owns numerous operating subsidiaries providing water services in locations across the United States.

HN1 TAWC, is required to obtain approval from the Tennessee Regulatory Authority (TRA or Authority), before implementing an increase in the [*3] rates it charges its customers. Term. Code Ann. *§ 65-5-103(a)*. TAWC's rates must be set forth in tariffs filed with and approved by TRA and TAWC can only charge the rates set forth in a duly filed and effective tariff. *Tenn. Code Ann. § 65-5-102*; Tenn. Comp. R. & Regs. 1220-4-1-.03. If TAWC wants to implement a rate increase due to increased expenses or investments or decreased revenues or for any other reason, it is required to file a revision to the existing tariffs and a petition asking TRA to approve the revision to the existing rates. *Tenn. Code Ann. § 65-5-103*; Tenn. Comp. R. & Reg. 1220-4-1-.03 to .06.

On March 14, 2008, TAWC filed its petition (2008 Rate Case) with the TRA in which it sought approval of "customer rates that will produce an overall rate of return of 8.514% on a rate base of $119,881,506". Along with the petition, TAWC filed the pre-filed testimony of nine witnesses, a Management Report and documentary evidence in support of the requested rate increase. This petition was TAWC's fourth such filing within a five year period.

On April 7, 2008, the TRA panel initially assigned to the 2008 Rate Case voted to suspend the proposed tariff from April 13, 2008 to July 11, [*4] 2008 and to convene a contested case proceeding and appoint a Hearing Officer for the purpose of preparing the matter for hearing before the panel.

On April 1, 2008, the Consumer Advocate and Protection Division of the Office of the Attorney General (Consumer Advocate or CAPD) filed a petition to intervene. The Chattanooga Manufactures Association (CMA) filed a petition to intervene, and the City of Chattanooga (the City) likewise filed a petition to intervene. There was no opposition to the petitions to intervene and the TRA permitted the interventions.

Between May 12, 2008 and mid-August 2008 extensive discovery was conducted by the parties and multiple motions were filed regarding discovery disputes. The hearing on the 2008 Rate Case commenced in Chattanooga on August 18, 2008 and continued there until August 22, 2008. The hearing was then reconvened in Nashville on August 26, 2008 and concluded on August 27, 2008.

The TRA panel held public deliberations on September 22, 2008. The TRA made numerous determinations of TAWC *s revenues, expenses, rate base and rate of return for the attrition year and concluded that TAWC had a revenue deficiency of $1,655,541. Accordingly, the TRA granted [*5] a rate increase to increase the revenue by $1,655,541. The TRA also ordered a "Request for Proposal" for an extensive management audit by an independent certified accountant of the management fees incurred by the TAWC from American Water Works Service Company (Service Company). The Request for Proposal was to be filed with the TRA no later than September 28, 2008.

On January 13, 2009, TRA entered the final order in the 2008 rate case, and TAWC filed a petition for direct review of numerous aspects of the TRA's decision pursuant to Term. Code Ann. *§ 4-5-322(b)(1)(B)(iii)* with the Middle Section of this Court. The Appellant, separately filed a motion to transfer the appeal of this case to the Eastern Section of the Court, which was granted.

Summary of Evidence Before the Authority

In ruling on TAWC's petition in the 2008 Rate Case, the TRA was required to make determinations on a number of complex components that must be considered when fixing just and reasonable rates and the Final Order of January 13, 2009 reflects those determinations. TAWC has sought review of the following contested issues that were a part of the multiple factors considered by the TRA: The selection of the test period; [*6] revenues, specifically Weather Adjustment Normalization; management fees, including the cost of the Management Audit performed by TAWC; fuel and power expenses, specifically the establishment of an unaccounted-for water loss percentage; and regulatory expense.

TAWC contends that TRA erred in applying more than one test year to TAWC's expenses, revenues and rate base. A "test period" or "test year" is a measure of a utility's financial operations and investments over a specific twelve month period. A test year is used to build an "attrition year", which is the forecast used to set rates. In this rate case TAWC urged TRA to use an historical test year ending on November 30, 2007 and the Consumer Advocate used a test year ending March 31, 2008. Both TAWC and the Consumer Advocate utilized an attrition year ending August 31, 2009. The issue of utilizing only TAWC's proposed test year was contested. In its final decision, the TRA utilized portions of

both test years for different determinations. The agency utilized the test period which it found to best fit the individual item being forecasted. Although TAWC contends that it was the policy of TRA in past rate cases to apply only one test [*7] period to all issues, the Consumer Advocate correctly pointed to the evidence that TRA had utilized multiple test year periods in the 2006 rate case.

TAWC described management fees as follows:

> Management fees are the charges from American Water Works Service Company ("AWWSC") for services provided under the 1989 Service Company contract. Those services consist of services related to accounting, administration, communication, corporate secretarial, engineering, finance, human resources, information systems, operations, rates and revenue, risk management, water quality and other services as agreed by the Company. These services are billed at cost to TAWC.

In the 2008 Rate Case, TAWC sought in its initial filing $4,335,190 for management fees.

In order to address this issue on appeal, a review of a portion of the Final Order in the 2006 Rate Case is required. As part of the 2006 Rate Case, TAWC initially requested management fees in the amount of $4,064,421. The Consumer Advocate requested that management fees be set in the amount of $3,021,111. The City and the CMA argued that the TRA should not approve any management fees as TAWC had not met its burden of proof on the issue. The TRA concluded [*8] that management fees for the attrition period should be $3,979,825. The TRA also ordered that TAWC have a management audit performed. The Final Order from the 2006 Rate Case specified the requirement of a management audit as follows:

> TAWC should have a management audit performed in compliance with Sarbanes-Oxley requirements and submit the results to the Authority in one year or, if the audit is not complete in one year, submit a status report on the audit in one year. This audit should determine whether all costs allocated to TAWC were incurred as a result of prudent or imprudent management decisions by TAWC's parent and should address the reasonableness of the methodology used to allocate costs to TAWC.

TRA had directed TAWC to submit the results of a management audit or a status report on the management audit within one year of deliberations in the 2006 Rate Case, which occurred on May 15, 2007. However, less than a year later, on March 14, 2008, TAWC filed its Petition in this case, the 2008 Rate Case, and with the Petition, it submitted a report prepared by the management consulting firm Booz Allen Hamilton (Booz Allen). This report was entitled and referred to by a Booz Allen vice-president, [*9] Joseph Van den Berg, who sponsored the report as an "Independent Cost Assessment Report". Mr. Van den Berg testified that the report was prepared in compliance with the 2006 Rate Case Final Order's requirement that a management audit be submitted to the TRA.

TAWC supported its request for management fees with the Booz Allen Report and Mr. Van den Berg's testimony as well as with testimony from TAWC officers and employees. TAWC offered evidence regarding the amount of projected management fees in the attrition year and attributed the increase in fees since the 2006 Rate Case to factors such as labor and benefits costs. TAWC further presented evidence that because the Service Company's costs and benefits are shared by all American Water subsidiaries, TAWC is able to deliver more prompt and reliable service to its customers. There was evidence that the Service Company offers a wide range of services to TAWC, including a customer call center, accounting, operations, rates and revenues, administration, auditing, information systems, communications, human resources, risk management, finance, legal, water quality and engineering. The Company witnesses offered testimony that all of these services [*10] were necessary for TAWC to provide a high quality of service to its customers and that if the Service Company was not employed, TAWC would have to obtain the same services elsewhere. TAWC provided evidence that if it shifted the services provided by the Service Company to the local level, the cost to TAWC would be higher because TAWC would have to hire full-time employees and outside contractors who would not bill at cost as the Service Company does.

The Company presented evidence to show that the Service Company was able to achieve cost savings based on its model that allows TAWC and other American Water subsidiaries to share in the cost of employing specialists, some of whom would not be needed in a full-time basis at a single utility. The Booz Allen consultant, Mr. Van den Berg, stated that in his opinion the service company model is a cost-effective way to operate utilities. Michael Miller, treasure/comptroller of the Company, attempted to explain the increase in management fees between 2004 and 2008. He stated that in 2004 and 2005 the Parent Company had instituted a company-wide reorganization that had shifted a number of fulltime positions from TAWC to the Service

Company. He [*11] claimed that this action resulted in a reduction in the growth of local labor costs that by 2008 had actually offset the increase in management fees by $1,239,713.

This evidence was presented in support of TAWC's initial request for management fees of $4,335,190. The Consumer Advocate arrived at a forecasted amount of $3,453,233 for the attrition period. The other intervenors, the City and the CMA, did not provide an alternative amount for management fees to the TRA, but rather the City urged that no management fees, including the cost of the management audit, be allowed until TAWC obtained a proper audit which would be reviewed in a later proceeding.

After review of the testimony, a majority of the TRA panel concluded that the management fees for the attrition period should be set at $3,529,933. This amount was based on the Company's forecasted 2005 management fee amount with an annual customer growth/inflation factor.

The TRA panel's decision on the amount of management fees was split two to one. All of the panel members, however, agreed that the Booz Allen Report submitted by TAWC did not comply with the TRA's directive in the 2006 Rate Case Final Order and did not support approval [*12] of TAWC's request to recover management fees in the 2008 Rate Case.

The deliberations of the members of the panel on this issue offer insight as to why the panel did not accept TAWC's management fees for the attrition year and why the panel rejected the Booz Allen Report. Director Roberson, as part of a motion, stated that he had no doubt that the Service Company had incurred legitimate expenses, but he had a problem determining whether the amount of management fees requested by the Company to pay the Service Company was "a just and reasonable amount based on prudent expenditures." He went on to state that the audit the TRA had ordered TAWC to conduct and provide to the TRA in the 2006 Rate Case could have answered this important question "if it had been conducted properly." He noted that the evidence presented showed that in the five and a half years from 2004 to the forecasted attrition period in the 2008 Rate Case, management fees had increased by 73%. The Director also addressed the testimony of Michael Miller regarding the company-wide reorganization that had shifted positions from TAWC in Chattanooga to the Service Company. He stated that there was less than $26,000 in efficiency [*13] gained by the reorganization since 2004 and that he had expected greater efficiency. He also stated that he looked forward to reviewing the conclusions of the comprehensive audit that was ordered in the 2006 Rate Case once it was properly prepared. He stressed that if the management audit shows that the management fees are prudent, the TRA will revisit the matter of management fees on its own motion or on motion of a party. He then explained his methodology for arriving at the management fees he approved.

Chairman Hargett voted in favor of Director Roberson's motion and added to the deliberations regarding the management audit ordered in the 2006 Rate Case. First the Chairman recapped the Final Order which required TAWC to submit a management audit to TRA: "The audit was to determine whether all costs allocated to [TAWC] were incurred as a result of prudent or imprudent management decisions by [the Service Company]." He then noted that the audit was to address the reasonableness of the methodology used to allocate costs to TAWC. Chairman Hargett expressed dissatisfaction with the Booz Allen Report as it did not meet those stated guidelines. He also expressed skepticism that Booz Allen [*14] was an independent company for purposes of conducting the audit as Mr. Van Den Berg, who oversaw the audit for Booz Allen, "frequently provides testimony for American Water Works Company in rate cases in other states." Finally the Chairman stated that he agreed with the methodology employed by the Director in arriving at the management fee figure of $3,529,933.

Director Freeman did not vote in favor of the management fees as proposed by Director Roberson and support by Chairman Hargett as he found that the Booz Allen Report submitted by TAWC did "not lend the evidence to support an increase in management fees from the last [2006] case." Based on this lack of evidence, Director Freeman stated that the management fees amount granted in the 2006 Rate Case should be adopted in the 2008 Rate Case.

> The Final Order in the 2008 Rate Case addressed the Booz Allen report as follows: Based on its evaluation, the City recommended disallowance of all costs related to the Booz Allen Report and all [the Service Company's] management fees and allocated cost until the Company obtains an audit that conforms to the specifications of the TRA and the new audit report is examined in a later proceeding. The [*15] City claimed, in part, that Booz Allen is not an independent public accounting firm; Booz Allen did not conduct an "audit" as required by the TRA or SOX [Sarbanes-Oxley regulations]; and Booz Allen did not conduct an audit in conformance with the rules of the Public Accounting Oversight Board....

The Final Order concluded:

> The record shows that from 2004 to the Company's forecasted attrition period in this docket, management fees have increased seventy-three percent during the five and one-half year time period. There was a fifty-nine percent increase between the 2004 fees and the fees approved in Docket No. 06-00290 [the 2006 Rate Case]. Therefore, a majority of the panel voted to set the Management Fee attrition year expense amount at $3,529,933. This amount was based on the Company's forecasted 2005 Management Fee amount from Docket No. 04-00288 [2005] as used by the Consumer Advocate in this docket. The majority of the panel voted to change the growth factor to include all customer growth instead of one-half of customer growth, as used by the Consumer Advocate.
>
> Because of unresolved questions regarding management fees assessed by the service company and requested by TAWC in Docket [*16] No. 06-00290 [the 2006 Rate Case], the TRA ordered TAWC to perform a management audit to determine whether all costs allocated to TAWC were incurred as a result of prudent or imprudent management decisions by TAWC's parent and to address the reasonableness of the methodology used to allocate cost to TAWC.

The Authority's June 10, 2008 Order in Docket no. 06-00290 stated at pages 26-27:

> TAWC should have a management audit performed in compliance with Sarbanes-Oxley requirements and submit the results to the Authority in one year or, if the audit is not complete in one year, submit a status report on the audit in one year. This audit should determine whether all costs allocated to TAWC were incurred as a result of prudent or imprudent management decisions by TAWC's parent and should address the reasonableness of the methodology used to allocate costs to TAWC.

A majority of the panel found that the management audit performed did not adequately address the issue of prudency of the management fees, and that the audit was not an independent audit as ordered in Docket No. 06-00290. The Booz Allen witness, Joe Van den Berg, who performed the management audit required by the TRA also provided [*17] testimony on behalf of TAWC in other dockets, both before the TRA and other utility commissions. For this reason, the panel determined that the independence of the selected audit firm was impaired. Further, the audit did not address the primary concerns of the Authority that the costs were the result of prudent management decisions.

Based on the foregoing findings regarding the Booz Allen Report, the TRA excluded amortization of the cost of the Booz Allen Report from the management fees. The Final Order also stated that because TAWC had not developed a Request For Proposal (REF) for a comprehensive management audit by an independent certified public accountant, as ordered in the 2006 Rate Case Final Order, TAWC had not complied with TRA's directive. The 2008 Rate Case Final Order provided specific criteria for a new audit:

> The REF for the audit shall include, but not limited to, an investigation of [the Service Company's] management performance and decisions relating to internal processes and internal controls with an attestation and recommendations of any needed management changes and implementation thereof Further, the audit shall evaluate and attest to the charges allocated to TAWC, [*18] including efficiency of processes and/or functions performed on behalf of TAWC, as well as the accuracy and reasonableness of the allocation factors utilized. This REF should be filed in this docket no later than six months from September 22, 2008.

On appeal, TAWC contends that the evidence presented to the TRA showed that the Booz Allen Report featured an in-depth analysis of the prudence of management decisions and cost allocation to TAWC by employment of management audit methodology and definition of prudence that has been used and accepted in multiple other jurisdictions. TAWC contends that Booz Allen examined and determined the prudence of TAWC's management decisions by examining seven aspects of the relationship between the Service Company and the Company and showed that the Service Company's costs per customer were less than most other utility companies that use a service company. Based on this finding, the report concluded that TAWC receives fair, reasonable and competitive charges from the Service Company.

Further, TAWC contends on appeal that the Booz Allen Report was in complete compliance with the applicable provisions of the Sarbanes-Oxley requirements as mandated by the [*19] 2006 Rate Case Final Order. Mr. Van den Berg stated in his pre-filed testimony that the Booz Allen report

and his testimony were intended to address the part of the Final Order of the 2006 Rate Case that 'TAWC have a management audit performed in compliance with Sarbanes-Oxley requirements'". Mr. Van den Berg also testified at the hearing on the issue of compliance with Sarbanes-Oxley. He stated that it was his understanding that the only Sarbanes-Oxley requirement that pertains to a management audit, as opposed to a financial audit, was that the firm conducting the management audit be independent from the company that it audited. Mr. Van den Berg claimed that the audit Booz Allen conducted was an independent audit, but on cross-examination, admitted that he had done consulting work for TAWC on the previous rate case and that in the past several years he had done consulting work and testified in rate cases for subsidiaries of the Parent Company in Minnesota, Missouri and Indiana.

Appellees find multiple faults with the Booz Allen Report and Mr. Van den Berg's testimony. For instance, appellees argue that Mr. Van den Berg did not undertake any analysis of whether the level of administration [*20] services, audit services, communication services and legal services that were charged by the Service Company to TAWC were the right level or quantity. Appellees claim Mr. Van den Berg did not undertake any independent analysis to determine whether the Service Company was actually providing the services it was billing to TAWC. An example of this allegation provided by appellees is that Mr. Van den Berg testified that he believed the charges for accounting services billed to TAWC were appropriate merely because the category of accounting services was included in the service agreement between the Service Company and TAWC. There was no evidence that he had examined the actual accounting services provided.

Appellees also assert that Booz Allen further did not undertake to study or determine whether amounts paid by TAWC for services were for the correct quantity or volume of service. The allegation is based on Mr. Van den Berg's testimony that other than having discussions with TAWC management, Mr. Van den Berg did not consider whether the services provided by the Service Company overlapped or duplicated activities conducted by TAWC employees nor did he consider the labor and benefits expense [*21] that TAWC was incurring locally. Appellees point to numerous other examples in the Booz Allen Report and in Mr. Van den Berg's testimony where there was no analysis of whether the services delivered to TAWC were necessary, reasonable and prudent. They also point out that the Booz Allen Report did not define prudence, imprudence or reasonableness.

The City offered the testimony of economic consultant Michael Majoros, Jr. as to why the Booz Allen Report was not a management audit, why it did not comply with Sarbanes-Oxley requirements and why it otherwise did not meet the requirements set forth in the Final Order of the 2006 Rate Case.

Mr. Majoros described the Sarbanes-Oxley Act of 2002:

> Sarbanes-Oxley(SOX) is an Act co-authored by Senator's [sic] Sarbanes and Oxley and signed into law by President George W. Bush. It emanates from the ENRON and other corporate scandals in [the] early part of President Bush's first term. SOX requires detailed audits by independent certified public accountants. The purpose of the law is "[t]o protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws and for other purposes.

Mr. Majoros was then [*22] asked how an "audit" is defined by Sarbanes-Oxley. In response he quoted Section 2(a)(2) of the Act as defining an audit as: "An examination of the financial statements of any issuer by an independent public accounting firm in accordance with the rules of the Board or the Commission (or, for the period preceding the adoption of applicable rules of the Board under section 103, in accordance with then-applicable generally accepted auditing and related standards for such purposes), for the purpose of expressing an opinion on such statements". In Mr. Majoros' opinion, the Booz Allen Report was not an audit, as described by Sarbanes-Oxley, but an "assessment" and he noted that Mr. Van den Berg never referred to the report as an audit. [1] Mr. Majoros provided three principal reasons that the Booz Allen Report was not a management audit: (1) the report did not determine and apply definitions of prudence, imprudence, or reasonableness; (2) it did not determine whether the internal controls at the Service Company were designed to catch imprudent costs; and (3) its conclusions were subjective and were not based on objective audit tests or standards. He also explained that there were well-defined [*23] standards for preparation of a management audit of a utility as provided in the National Association of Regulatory Utility Commissioners publication, "Fundamental of Management Audits, Vol. I" and that Booz Allen had not utilized these standards.

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[1] As noted above in footnote 2, Mr. Van den Berg testified that although he had referred to the report as a "cost assessment" he used the term "assessment" synonymously with audit. In fact, the Booz Allen report also refers to "report" and "audit" interchangeably in the first paragraph.

Mr. Majoros further detailed twelve deficiencies in the Booz Allen Report, referenced as BAH, that caused it to be non-compliant with Sarbanes-Oxley (SOX)requirements:

> BAH is not an independent public accounting firm. [2] BAH did not conduct an "audit" as specified by SOX. BAH did not conduct an audit in conformity with or even cite to the rules of the Public Company Accounting Oversight Board. BAH did not cite to professional standards and did not comply with stringent standards SOX requires. BAH's report did not include a concurring or second partner review and approval of such report. BAH's report did not contain any management attestations. BAH's report is not [*24] independent, it was reviewed and edited by management. BAH's report did not describe the scope of the auditor's testing of the internal control structure and procedures required by section 404(b) Internal Control Evaluation and Reporting. BAH's report did not present the findings of the auditor from such testing. BAH's report did not provide an evaluation of whether AWWSC's [the Service Company's] internal control structure and procedures include maintenance of records that in reasonable detail accurately and fairly reflect the transactions reported to BAH by AWWSC. BAH' report did not provide an evaluation of whether such internal control structure and procedures provide reasonable assurance that transactions are recorded as necessary to permit calculation of costs conforming to TRA requirements, and that receipts and expenditures underlying those costs are being made only in accordance with authorizations or management and directors in conformance with TRA rules. BAH's report did not contain a description, at a minimum, of material weaknesses in such internal controls, and of any material noncompliance found on the basis of such testing.

Mr. Majoros summarized his opinions as follows:

> BAH did not conduct a management audit in compliance with Sarbanes-Oxley requirements to determine whether all costs allocated to TAWC were incurred as a result of prudent or imprudent management decisions by TAWC's parent and the reasonableness of the methodology used to allocate costs to TAWC, as TRA specified in Docket No. 06-00290. The BAH Report is merely an expansion of the type of study Mr Baryenbruch submitted in Docket no. 06-00290 which led to the TRA's Sarbanes-Oxley requirement. BAH did not conclude audit test work of specific transactions to determine if they were the result of prudent or imprudent management decisions. Nor did he determine or verify if AWWSC's internal controls were designed to catch imprudent and unreasonable costs. The BAH Report is not useful for ratemaking purposes. None of the costs of the BAH Report should be charged to ratepayers in any way. Furthermore, I recommend disallowance of all AWWSC management fees and allocated costs until the originally specified audit is conducted and examined in a later proceeding.

TAWC offered the testimony of Mark Manner, [*26] an attorney and purported expert on the Sarbanes-Oxley requirements, in rebuttal to Mr. Majoros' opinions. Mr. Manner provided an overview of the Sarbanes-Oxley Act of 2002, also known as the Public Company Accounting Reform and Investor Protection Act of 2002. According to Mr. Manner, the Act was designed to improve existing safeguards for protecting investors in public companies from corporate accounting fraud, primarily by improving the accuracy and reliability of public company disclosures and by strengthening the independence of accounting firms auditing those disclosures. Mr. Manner first gave a definition of a management audit:

> [A] "management audit" is a broad and general term. It is often used to describe management consulting services that are used to assist in the evaluation of the performance of a company's management or operations. The precise scope of a "management audit" is generally subject to additional description or definition by the party requesting such an audit.

Mr. Manner went on to distinguish a "management audit" from a "financial statement audit" which he defined as an "evaluation or assessment of a [c]ompany's balance sheet, income statement, cash flow statement, [*27] and related notes. A financial statement audit leads to an audit report providing an opinion as to whether the financial statements of a company fairly present the financial positions and results of operations of a company in accordance with generally accepted accounting principles. He explained that the word "audit" for purposes of Sarbanes-Oxley is defined

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[2] Booz Allen Hamilton refers to itself as a "Strategy [*25] and Technology Consulting Firm" on its website.

narrowly as an "examination of the financial statements of any issuer by an independent public accounting firm . . . ." Therefore, when Sarbanes-Oxley addresses "audit" requirements and standards it applies to financial statement audits of publically traded companies and does not apply to a "management audit". In Mr. Manner's pre-filed testimony, he was asked the question "what does Sarbanes-Oxley require for a "management audit" or for any other types of non-financial statement audits?" His response to this question is key to understanding his and TAWC's position regarding the 2006 Rate Case Final Order's requirement that TAWC's management audit be compliant with Sarbanes-Oxley:

> Sarbanes-Oxley makes it clear that the independent public accounting firm that audits the AWWC [the Parent Company] financial statements, in this case [*28] PricewaterhouseCoopers ("PWC"), is prohibited from providing certain services that Sarbanes-Oxley defines as "non-audit" services" such as the management audit. This prohibition requires an independent third-party, other than AWWC's independent public accounting firm, to conduct the management audit. This requirement of independence for the management audit can be fulfilled by having another party, accounting firm or otherwise, conduct the management audit. AWWC complied with this requirement by hiring Booz Allen to conduct the management audit.
>
> Otherwise,... Sarbanes-Oxley sets forth requirements for financial statement audits rather than management audits or other types of audits. This becomes obvious upon reviewing the Sarbanes-Oxley definition of "audit" that covers "an examination of the financial statements . . . for the purpose of expressing an opinion on such statements" and the definition of "non-audit services," which covers professional services "other than those provided in connection with an audit or other review of the issuer's financial statement."
>
> * * * *
>
> Although Sarbanes-Oxley's applicability to management audits is limited to independence as discussed above, I note [*29] that the management audit filed in this case pursuant to the TRA Order is based on financial information underlying the financial statements of AWWC that were prepared and audited in compliance with applicable Sarbanes-Oxley provisions, and was from a company that was in compliance with applicable Sarbanes-Oxley provisions.(emphasis supplied, citations omitted).

Mr. Manner stated that the TRA Final Order in the 2006 Rate Case specified that the management audit should be performed in compliance with Sarbanes-Oxley, which Mr. Majoros incorrectly interpreted as requiring a financial audit process. It was Mr. Manner's opinion that the correct interpretation of the Order is that it was a "clear request that the management audit be prepared by an independent firm." He also reiterated that "the Booz Allen management audit incorporates and is underpinned by financial information from a Sarbanes-Oxley compliant company that flows from financial statements prepared and audited [by PWC] in compliance with Sarbanes-Oxley", thus the Booz Allen report satisfied the TRA's mandate that it be compliant with Sarbanes-Oxley.

Mr. Manner did not address Mr. Majoros's primary opinion the Booz Allen Report [*30] did not address whether all costs allocated to TAWC were incurred as a result of prudent or imprudent management decisions by TAWC's parent and the reasonableness of the methodology used to allocate costs to TAWC.

The Final Order contains the following discussion of how the panel determined attrition period revenues:

> The panel adopted attrition period Revenues of $38,934,309. In doing so, the panel used a combination of the Company's, the Consumer Advocate's, and its own forecasts. The panel found neither the Company's nor the Consumer Advocate's methodology for forecasting residential and commercial average usage persuasive and instead performed its own analysis, examining average usage trends for the residential and commercial classes over the four years ended March 31, 2005, 2006, 2007 and 2008. The Authority adopted residential class attrition period revenues based on this methodology and the Company's forecasted number of bills. For commercial class, the analysis produced a result almost identical to the Company's forecast; therefore, the Authority adopted TAWC's commercial class attrition period revenue forecast.

The TRA, in addressing weather normalization adjustment (WNA) in the [*31] Final Order, noted that TAWC had inaccurately represented that the agency had previously adopted the model the Company used in forecasting residential and commercial average usage. The Order states:

> In earlier TAWC rate case dockets, Docket Nos. 03-00118 and 04-00288, TAWC's revenues were

> settled. Although the parties in those dockets settled on the amounts proposed by TAWC, the settlements did not mention any agreed upon methodology for calculating those revenues. The Company's revenue forecast was adopted in Docket No. 06-00290; however, the Authority did not adopt or endorse TAWC's WNA model. In this docket, the panel did not adopt the Company's entire revenue forecast or the Company's WNA model. Nevertheless, the Authority adopted the Company's commercial class attrition period revenue in this docket because despite disagreeing with the Company's methodology, the result was reasonable.

TAWC projected Regulatory Expenses of $543,384 in its Petition. This amount included the unamortized portion of the 2006 Rate Case regulatory expenses and the estimated cost of the 2008 Rate Case. The Consumer Advocate estimated $341,868 for Regulatory Expenses for the attrition period and the CMA [*32] projected Regulatory Expenses in the amount of $287,111. The expenses incurred in this case were higher than the 2006 Rate Case due, according to TAWC, to contentious discovery and multiple pre-hearing motions and hearings. TAWC, in its brief, claims that the reasonableness of the Rate Case expenses was uncontested. This statement is not borne out by the filings and testimony of the intervenors on this issue. In fact, the intervenors argued that the attorneys' fees claimed by TAWC as part of its regulatory expense were not reasonable and should not be approved by the TRA. The TRA rejected the arguments of the intervenors, but did look at whether the expense of regulatory proceedings should be apportioned and determined that it would be appropriate for TAWC shareholders to bear a portion of the Company's rate case expense as follows:

> The panel noted that in the future the Authority should closely examine the costs associated with rate case filings to determine the portions to be recovered from rate payers and shareholders. The panel voted to allow one-half of this docket's rate case expense of $275,000 in the calculation of the Regulatory Expense. The panel voted to have one-half of [*33] the rate case expense, the cost of the service study, the cost of the depreciation study, and the unamortized balance of the previous case amortized over a three year period. Thus, the panel adopted $194,852 as the Regulatory Expense for the attrition period.

In any water system, some water is lost through leaks or waterline breaks. Also, a portion of water provided to customers is not billed, for example water used in fighting fires and used in leak detection. The lost or unbilled water is referred to as unaccounted-for water (UfW). TAWC presented testimony that its UfW for the attrition year was 19.97 % which is approximately 5% higher than the industry standard for acceptable UfW of 15%. The Consumer Advocate and CMA, through expert testimony, cross-examination of TAWC witnesses and post-hearing briefs, made the argument that the amount of TAWC's chemical and fuel and power costs incorporated in rates should be adjusted by 15% to provide incentive for the Company to maintain its water system more efficiently and prevent wasted costs for non-revenue producing treated water.

TAWC presented testimony that although all water systems have UfW, a system located in a mountainous area, such [*34] as Chattanooga, or that has older infrastructure, as does TAWC, may have more UfW than otherwise situated or newer systems. Based on these circumstances, TAWC argued that the 15% UfW industry standard should not apply to TAWC. The Company also presented evidence regarding its effort to reduce the level of UfW by introducing a non-revenue water program, increasing leak detection in the system and conducting a water audit.

There was also testimony a UfW standard of 15% has been generally accepted by at least two regulatory agencies in other states and is generally accepted in the water utility industry. In fact, Mr. Watson, the president of TAWC, admitted that the Company itself sets a 15 % UfW target for itself and that the 15% standard is a good industry average. CMA witness Michael Gorman recommended that an acceptable UfW standard should be no more than 15%. He based his recommendations on two studies relied upon by the water utility industry. The TRA determined in the Final Order that the 15% standard should apply to TAWC to encourage conservation of natural resources.

The issues presented for review are:

> A. Did the TRA err when it employed a rate-making methodology that utilized more [*35] than one test year?
>
> B. Whether the TRA's determination of management fees was arbitrary and capricious or in violation of *Tenn. Code Ann. § 65-5-103*?
>
> 1. Whether the TRA's decision to disallow recovery of the expense of a TRA ordered management audit was arbitrary and capricious?

C. Whether the TRA properly normalized revenues using a reasonable weather normalization adjustment methodology?

D. Whether the decision to reduce the recovery of rate case expense was a lawful exercise of discretion supported by material and substantial evidence?

E. Whether the TRA's decision to cap unaccounted-for water at 15% was a lawful exercise of discretion supported by material and substantial evidence?

HN2 This Court's review of the TRA's actions is confined to the record. *Tenn. Code Ann. §4-5-322(g)*. The standard of review to be employed by the Court is provided by *Tenn. Code Ann. §4-5-322(h)* as follows:

HN3 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 [*36] 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.

HN4 This Court's review is for the 'very limited purpose of determining whether the Commission has acted arbitrarily, or in excess of jurisdiction, or otherwise unlawfully." *CF Indus. v. Tennessee Pub. Serv. Comm'n, 599 S.W.2d 536, 540 (Tenn. 1980)*(citing *City of Whitwell v. Fowler, 208 Tenn. 80, 83, 343 S.W.2d 897, 899 (1961)*). Review is restricted to the record and the TRA's finding may not be reversed or modified unless arbitrary or capricious or characterized by an abuse, or clearly unwarranted exercise of discretion and must stand if supported by substantial and material evidence. *Id*. The Tennessee Supreme [*37] Court discussed the degree of deference the reviewing court should give to the administrative agency as follows:

> The criteria by which the [Authority] should be guided have received only generalized comments in our reported decisions. This is proper because the courts are playing a limited role in reviewing actions which essentially are legislative in character. Rate making is not a judicial function and we accord the [Authority] great deference in reviewing its decisions. On fixing rates in general the Court has spoken in terms of what is just and reasonable "under the proven circumstances," of "regard to all relevant facts" and to a rate "in the zone of reasonableness."

C. F. Indust. at 542 (citing Southern Bell T. & T Co. v. Tennessee Public Serv. Com'n., 202 Tenn. 465, 304 S.W.2d 640 (1957)).

Moreover, ***HN5*** this Court will not disturb a reasonable decision of an agency with expertise, experience and knowledge in the appropriate field. *S. Ry. Co. v. State Bd. of Equalization, 682 S.W.2d 196, 199 (Tenn. 1984)*(citing *Griffin v. State, 595 S.W.2d 96, 99 (Tenn. Crim. App. 1980)*). There is also a presumption that the rates so established are correct and any party who attacks the Commission's [*38] findings has the burden of proving that they are illegal or unjust and unreasonable. *CF Indus. at 540* (citing *Southern Bell T. & T. Co., 202 Tenn. 465, 304 S.W.2d 640 (1957)*). When the rates set by the agency are attacked there is a heavy burden on those who attacked them to make a convincing showing that the rates are invalid. *S. Bell Tel. & Tel. Co.*, 304 S.W.2d at 649.

This Court discussed the standards of review for *Tenn. Code Ann. § 4-5-322(h)(4)* and *Tenn. Code Ann. § 4-5-322(h)(5)* in *Jackson Mobilphone Co., Inc. v. Tennessee Pub. Serv. Comm'n*, 876 S.W.2d 106, 110-11 (Tenn. Ct. App. 1993) with specificity, as follows:

> ***HN6*** The standards of review in *Tenn. Code Ann. § 4-5-322(h)(4)* and *Tenn. Code Ann. § 4-5-322(h)(5)* are narrower than the standard of review normally applicable to other civil cases. They are also related but are not synonymous. Agency decisions not supported by substantial and material evidence are arbitrary and capricious. *CF. Indus., Inc. v. Tennessee Public Serv. Comm'n, 599*

S.W.2d 536, 540 (Tenn.1980); Pace v. Garbage Disposal Dist., 54 Tenn. App. 263, 390 S.W.2d 461, 463 (1965). However, agency decisions with adequate evidentiary support may [*39] still be arbitrary and capricious if caused by a clear error in judgment. Bowman Transp., Inc. v. Arkansas-Best Freight Sys., Inc., 419 U.S. 281, 284, 95 S. Ct. 438, 441-42, 42 L.Ed.2d 447 (1974); Girard v. City of Glenn Falls, 173 A.D.2d 113, 577 N.Y.S.2d 496, 499 (1991); 5 Kenneth C. Davis, *Administrative Law Treatise* § 29:7, at 358 (2d ed. 1984).

A reviewing court should not apply Tenn.Code Ann. § 4-5-322(h)(4)'s "arbitrary and capricious" standard of review mechanically. In its broadest sense, the standard requires the court to determine whether the administrative agency has made a clear error in judgment. American Paper Inst. v. American Elec. Power Serv. Corp., 461 U.S. 402, 413, 103 S.Ct. 1921, 1928, 76 L.Ed.2d 22 (1983); Citizens to Preserve Overton Park, Inc. v. Volpe, 401 U.S. 402, 416, 91 S.Ct. 814, 823-24, 28 L.Ed.2d 136 (1971). An arbitrary decision is one that is not based on any course of reasoning or exercise of judgment, State ex rel. Nixon v. McCanless, 176 Tenn. 352, 354, 141 S.W.2d 885, 886 (1940), or one that disregards the facts or circumstances of the case without some basis that would lead a reasonable person to reach the same conclusion. Wagner v. City of Omaha, 236 Neb. 843, 464 N.W.2d 175, 180 (1991); [*40] Ramsey v. Department of Human Servs., 301 Ark. 285, 783 S.W.2d 361, 364 (1990).

Likewise, ***HN7*** a reviewing court should not apply Tenn.Code Ann. § 4-5-322(h)(5)'s "substantial and material evidence" test mechanically. Instead, the court should review the record carefully to determine whether the administrative agency's decision is supported by "such relevant evidence as a rational mind might accept to support a rational conclusion." Clay County Manor v. State Dep't of Health & Environment, 849 S.W.2d 755, 759 (Tenn.1993); Southern Ry. v. State Bd. of Equalization, 682 S.W.2d 196, 199 (Tenn. 1984). The court need not reweigh the evidence, Humana of Tennessee v. Tennessee Health Facilities Comm'n, 551 S.W.2d 664, 667 (Tenn. 1977), and the agency's decision need not be supported by a preponderance of the evidence. Street v. State Bd of Equalization, 812 S.W.2d 583, 585 (Tenn.App. 1990). The evidence will be sufficient if it furnishes a reasonably sound factual basis for the decision being reviewed. Wayne County v. Tennessee Solid Waste Disposal Control Bd., 756 S.W.2d 274, 279 (Tenn.App. 1988).

Jackson Mobilphone at 110-111.

The substantial and material evidence standard has been described as [*41] requiring "something less than a preponderance of the evidence . . . but more than a scintilla or glimmer."" Bd. of Prof'l Responsibility v. Allison, 284 S.W.3d 316, 322 (Tenn.2009)(citing Jones v. Bureau of TennCare, 94 S.W.3d 495, 501 (Tenn.Ct. App.2002)).

HN8 The TRA's conclusions of law are subject to a *de novo* review without a presumption of correctness. Tennessee Envtl. Council, Inc. v. Tennessee Water Quality Control Bd., 254 S.W.3d 396, 402 (Tenn. Ct. App. 2007).

A fundamental tenet of the legislative function of ratemaking requires the balancing of the utility's interest in performing its public duties and earning a reasonable return on investment. Bluefield Waterworks & Improvement Co. v. Pub. Serv. Comm'n of W.Va., 262 U.S. 679, 691 - 693, 43 S. Ct. 675, 67 L. Ed. 1176 (1923). Rates are set for the future, and the estimated effect of all reasonably expected changes affecting the rate of return, including increases in expenses and investments, must be taken into consideration in the establishment of a rate. Am. Asss'n. of Retired Persons v. Tenn. Pub. Sev. Comm'n., 896 S.W.2d 127, 133 (Tenn. Ct. App. 1995). Thus, "a rate should be reasonable not only when it is first established but also for a reasonable time [*42] thereafter." Southern Bell Tel. & Tel., 304 S.W.2d at 647(citing McCardle v. Indianapolis Water Co., 272 U. S. 400, 47 S. Ct. 144, 71 L. Ed. 316 (1926)).

HN9 A necessary component of utility ratemaking is the authority of TRA to "fix" just and reasonable rates, not simply to approve or deny a utility's request. This Court, in *Consumer Advocate Div. v. Bissell*, noted:

> [T]he 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).

*Bissell, No. 01-A-01-9601-BC00049, 1996 Tenn. App. LEXIS 528, 1996 WL 482970 at * 2 (Tenn. Ct. App. Aug. 28, 1996)*(emphasis added).

In ratemaking proceedings, the burden of showing the proposed rates are just and reasonable rests with the utility seeking the change in rates. (*Tenn. Code Ann. § 65-5-103(a)*.

TAWC argues that TRA's use of multiple [*43] test years was an arbitrary change of its policy unsupported by substantial and material evidence. In support of this argument it cites *United Cities Gas Co. v. Tennessee Public Serv. Com'n, 789 S.W.2d 256 (Tenn. 1990)*. That case, however, held that "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. *Id. at 259* (citing *Public Service Commission v. General Telephone Company, etc.*, 555 S.W.2d 395 (Tenn.1977)).

TAWC and TRA both set out the rate making methodology employed by the TRA in their briefs. TAWC, relying in part on the testimony of the Consumer Advocate's witness, Terry Buckner, explained that in rate cases, TRA uses a standard methodology to determine if the rates proposed by a utility are just and reasonable. The utility selects a historical "test period" which is usually a recently completed twelve month period. Detailed information regarding the utility's revenues, expenses, rate base and cost of capital for the selected test year is then analyzed. Based on the data from the selected test period, a forecast of revenues, expenses, rate [*44] base, and cost of capital is created for the "attrition period" or "attrition year", usually a twelve month period commencing approximately at the anticipated conclusion of the rate case. The attrition period is to be representative of the period of any rate adjustment and is also viewed as the first year during which the TRA's rate order will be applied. Mr. Buckner explained that the selection of the test year is quite important:

> The selection of the timing of the test year may be the most significant single factor in the rate-making process. The more outdated the test year levels operations, the more critical is the need for significant restatement to produce representative levels of future conditions.

Mr. Buckner went on to explain that in the 2008 Rate Case TAWC used a test year that ended November 2007 and an attrition year ending August 2009, whereas the Consumer Advocate used a test year ending March 2008 and its attrition year ending August 2009. He explained that the Consumer Advocate used the later test year "[i]n an effort to eliminate outdated financial information and to shorten the forecast window . . . . " (*Id.* at 0647).

The TRA stated in the Final Order that it is "not [*45] limited to adopting one test period for use throughout the case" and that both TAWC's and the Consumer Advocate's tendered test periods were acceptable and that it voted to use "the test period which best fits the individual items being forecasted." In addition, the TRA performed its own analysis for revenues and examined average usage trends over the four years ended March 2005, 2006, 2007 and 2008. The TRA then used this resulting revenue forecast to determine chemical and fuel expenses and it decided not to use a test period analysis when calculating management fees. TAWC contends that TRA's use of multiple test years in the 2008 Rate Case was a departure from its prior policy and that TRA had "expressly rejected the use of multiple test years in the 2006 Rate Case. TAWC claims that in the 2006 Rate Case, TRA stated that it rejected the multiple test periods utilized by Consumer Advocate and accepted TAWC's uniform test period. However, TAWC's contention that TRA rejected the use of multiple test periods is not born out by the June 10, 2008 Order in the 2006 Rate Case. That Order states as follows:

> The Company selected a historical test period of the twelve months ended June 30, [*46] 2006 and an attrition period of the twelve months ending February 29, 2008....
>
> The CAPD used a test period of the twelve months ended December 31, 2006 for Revenues. The CAPD used a test period of the twelve months ended October 31, 2006 for the majority of Operations and Maintenance Expenses. For labor related expenses, the CAPD adopted the Company's actual employee level as of January 31, 2007. The CAPD forecast the Plant in Service and Accumulated Depreciation was based on actual balances at December 31, 2006 plus monthly additions and retirements as provided by the Company. The attendant depreciation expense was calculated upon resulting balances
>
> The panel rejected the multiple test periods utilized by CAPD to forecast Revenues and Expenses and accepted the Company's uniform test period of the twelve months ended June 30, 2006 for Revenues and Expenses, except in the instance of Insurance Other Than Group where abnormal monthly bookings were noted. Further, the panel voted to accept the test period of the twelve months ended

> June 30, 2006 for Revenues and Expenses, except in the instance of Insurance Other Than Group where abnormal bookings were noted. Further the panel voted to [*47] accept the test period of the twelve months ended June 30, 2006 for Rate Base components to which the Company and the CAPD agree in their projections. For Rate Base components to which there was dispute among the Parties, the panel adopted the actual average thirteen month ending at December 31, 2006....

(Final Order, TRA Docket No. 06-00290, June 10, 2006, pp. 19 - 20 (2006 Rate Case)).

The foregoing excerpt from the Final Order from the 2006 Rate Case shows that while TRA did not accept the specific multiple test periods advocated by CAPD for various factions of the rate case, it did not reject the use of multiple test periods when it found them appropriate. In fact, TRA specifically rejected TAWC's test period of the twelve months ending on June 30, 2006 for the Rate Base components that were in dispute among the parties, and instead, applied a test period ending December 31, 2006. *Id.*

Accordingly, TAWC's contention that TRA's use of multiple test periods in the 2008 Rate Case was an arbitrary change of policy that is unsupported by the substantial and material evidence fails, as the Final Order from the 2006 Rate Case clearly shows that TRA utilized more than one test year in that [*48] case. [3]

We note that the TRA's discretion with regard to setting rates and the manner in which the agency utilizes test periods is settled law. ***HN10*** The TRA has the discretion to utilize an historical test period, a forecast period, a combination of these where necessary, or any other accepted method of rate making necessary to give a fair rate of return. *Powell Tel. Co. v. Tennessee Pub. Serv. Comm'n, 660 S.W.2d 44, 46 (Tenn. 1983)*; *Am. Ass'n of Retired Persons v. Tennessee Pub. Serv. Comm'n, 896 S.W.2d 127, 133 (Tenn. Ct. App. 1994)*. The Supreme Court in *Powell* noted that "there is no statutory nor decisional law that specifies any particular approach that must be followed by the Commission. Fundamentally, the establishment of just and reasonable rates is a value judgment to be made by the Commission in the exercise of [*49] its sound regulatory judgment and discretion." *Powell at 46* (citing *CF Industries., 599 S.W.2d at 542*.

Accordingly, neither the courts nor the legislature has established any precise method or formula in setting rates, and the TRA is not bound by any particular approach. *CF Industries, 599 S.W.2d at 543*. As the TRA noted in the Final Order of the 2008 Rate Case, it is not limited to adopting one specific test period in order to make known and measurable adjustments to produce just and reasonable rates. There is simply no requirement that the TRA utilize the specific test period proposed by a public utility.

TAWC contends that the TRA's Final Order in the 2008 Rate case regarding management fees was arbitrary and capricious and violated *Tenn Code Ann. § 65-5-103* as it was not supported by substantial and material evidence, did not allow recovery for reasonably expected expenses and was based on the TRA's disregard of overwhelming undisputed evidence. TAWC also contends that the TRA was in error when it rejected TAWC's projected attrition year management fees of $4,335,190 and, instead, set the management fees for the attrition year at $3,529,933. TAWC finds fault with the TRA's setting [*50] of management fees based on the amount TAWC forecasted for 2005 in a 2004 Rate Case, which TRA then adjusted upward for inflation and customer growth.

While TAWC contends that its request for management fees of $4,335,190 was supported by "overwhelming undisputed evidence" this is not supported by the record. The record shows that the City and Consumer Advocate presented a vast amount of substantial and material evidence that not only contradicted the evidence put forth by TAWC but supported the final decision made by the TRA. The issue of the management fees requested by TAWC and the Booz Allen Report are inextricably intertwined in the reasoning and Final Order of the TRA in this case. The City and the Consumer Advocate produced extensive evidence regarding the deficiencies of the Booz Allen Report, some of which are detailed heretofore. The TRA was obviously persuaded by this evidence as it concluded in the Final Order that the Booz Allen Report did not adequately address the prudency of the charges imposed on TAWC by the Service Company.

The record in this case demonstrates that the TRA did not act arbitrarily in limiting the amount of management fees for TAWC. ***HN11*** In its broadest sense, [*51] the arbitrary and capricious standard requires this Court to determine whether the administrative agency has made a clear error in

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[3] The City of Chattanooga appealed the decision of the TRA in the 2006 Rate Case. TAWC, as appellee, did not raise the issue of whether TRA's use of more than one test period in the 2006 Rate Case was an arbitrary derivation from standing TRA policy. *See City of Chattanooga v. Tennessee Regulatory Auth.*, M2008-01733-COA-R12-CV, 2010 Tenn. App. LEXIS 459, 2010 WL 2867128 (Tenn. Ct. App. July 21, 2010).

judgment or a decision not based on any course of reasoning or exercise in judgment. *Jackson Mobilphone*, 876 S.W.2d at 110-11. The TRA's decision to reject the Booz Allen Report and other evidence submitted by TAWC to substantiate its projected management fees is supported by material and substantial evidence submitted by the intervenors that a "rational mind might accept to support a rational conclusion". Thus, TAWC did not meet its "heavy" burden of proof that it was entitled to recover $4,335,190 for management fees. Accordingly, we affirm the TRA's decision to award a lessor amount for management fees than requested by TAWC, which was an appropriate exercise of the agency's discretion.

TAWC also appeals the TRA's finding that Booz Allen did not conduct an independent audit as required by the Final Order in the 2006 Rate Case. The TRA found that Mr. Van den Berg, who sponsored the Booz Allen Report, was not independent of TAWC because he had testified on behalf of the Company before the TRA and in other states as an expert witness on behalf of the Parent [*52] Company. TAWC contends that the independence imposed by TRA in its Final Order in the 2008 Rate Case was never required in the Final Order in the 2006 Rate Case. This argument is contrary to the testimony of two of TAWC's own witnesses. The Final Order in the 2006 Rate Case mandated that the management audit be in compliance with Sarbanes-Oxley requirements. Mr. Van den Berg and Mr. Manner testified that the only requirement contained in Sarbanes-Oxley that pertains to a management audit or a non-financial audit was that the audit be conducted by an independent firm. As the Final Order in the 2006 Rate Case required compliance with Sarbanes-Oxley and Sarbanes-Oxley requires a nonfinancial auditor to be independent of the company being audited, the Final Order mandated independence. We find this argument without merit.

There is, however, a valid question as to whether the TRA's finding that Booz Allen was not independent of TAWC was correct. Mr. Manner and Mr. Van den Berg, testifying on behalf of TAWC, both stated that the independence requirement in Sarbanes-Oxley as to non-financial statement audits means that such an audit could not be conducted by the financial auditors who conducted [*53] financial audits for a company. They both interpreted this provision to mean only that PricewaterhouseCoopers, the financial auditors for TAWC, could not have conducted the management audit of TAWC under the independence requirement of Sarbanes-Oxley. Thus, TAWC takes the position that if independence had been required by the Final Order, then Booz Allen was an independent auditor as it was never TAWC's financial auditor. The TRA and the other appellees contend that because Mr. Van den Berg had acted as an expert witness for TAWC and its Parent Company in other matters, he was an advocate for the company and could not be independent. The TRA also points to the testimony of Mr. Van den Berg that he submitted a draft of the Booz Allen Report to TAWC to review and make corrections before he put it in final form as proof that he did not conduct an independent audit. In fact, Mr. Van den Berg stated that TAWC did make some changes to the facts presented in the draft report but made no modification of the analysis. However, we have already affirmed the TRA's rejection of TAWC's requested management fees on another basis, i.e., that TAWC did not meet its burden of proof to show that the charges [*54] it requested were prudent.

TAWC also appeals the TRA's setting the projected management fees for the attrition year at $3,529,933 based on the management fees forecasted for 2005 with an upward adjustment for inflation and customer growth. This methodology was advanced by the Consumer Advocate and accepted by the TRA only after the agency determined that the Booz Allen Report and the other evidence presented by TAWC was insufficient to meet TAWC's burden of proof as to the prudency of the Service Company's charges to TAWC.

This issue was addressed by the TRA panel at the hearing. Director Roberson stated that he had no doubt that the Service Company had incurred legitimate expenses, but he could not determine whether the amount of management fees requested by the Company was "a just and reasonable amount based on prudent expenditures" from the Booz Allen Report. He then recommended adopting the methodology advanced by the Consumer Advocate as a way to include management fees in the rate. Director Roberson made it clear that once TAWC had a properly prepared comprehensive management audit done, the TRA would revisit the matter of management fees if the audit showed that the management [*55] fees requested were prudent. Accordingly, the Final Order left the 2008 Rate Case open so that TAWC could have the opportunity to obtain a properly conducted management audit in compliance with the Order and submit it to the TRA for consideration. This audit was to be filed within six months of September 22, 2008. Until such time as a management audit was submitted to the TRA, the agency, in recognition that TAWC had

incurred some management fees, set the management fees at $3,529,933. [4]

TAWC objects to the TRA utilizing the methodology proposed by the Consumer Advocate on the basis that the agency had rejected the same methodology, which had also been proposed by the Consumer Advocate, in the 2006 Rate Case. TAWC contends that the TRA's use of this methodology was not supported by the record, failed to give substantial weight to the TRA's 2006 Order and was made without good cause and prior notice to the parties. TAWC maintains that the 2005 forecast made in 2004 Rate Case is not material and there is substantial [*56] evidence to support such a decision on management fees in the 2008 Rate Case.

Based on the Authority's finding as to the inadequacy of the Booz Allen Report, there was no substantive evidence before the TRA to support the reasonableness, necessity and prudence of the increase in management fees sought by TAWC. The transcript of the panel's deliberations makes clear that the members accepted that some management fees had been incurred by TAWC. Left with such an evidentiary vacuum, caused by TAWC, the agency used its discretion and arrived at its own value judgment based on its findings in the 2004 Rate Case. The management fees set by the TRA were to be revisited within six months upon a filing of an appropriate management audit by TAWC. The setting of just and reasonable rates is a value judgment to be made by the TRA in the exercise of its sound regulatory judgment and discretion. *CF Indus. 599 S.W.2d at 542*. The TRA recognized the need to set management fees but found that it was provided with inadequate proof as to the prudence of the fees requested by TAWC. Using the fees from 2005 was a reasonable, temporary solution to the dilemma until TAWC could submit a proper management audit. [*57] As noted, ***HN12*** the arbitrary and capricious standard requires this Court to determine whether the administrative agency has made a clear error in judgment or a decision not based on any course of reasoning or exercise in judgement. *Jackson Mobilphone*, 876 S.W.2d at 110-11. We hold this action was not arbitrary and capricious and the use of the 2005 management fees, under the circumstances, was not error.

TAWC argues that the TRA erred when it disallowed TAWC's request to recover $285,000 it paid for the preparation of the Booz Allen Report. To support this position, TAWC makes the same argument it made regarding its argument that the TRA erred when it did not accept the findings of the Booz Allen Report. The TRA panel concluded that the Booz Allen Report did not comply with the Final Order in the 2006 Rate Case because it did not adequately address the prudency of the management fee and because Mr. Van den Berg, the sponsor of the Report, was not independent as required by Sarbanes-Oxley. Based on this finding, the TRA declined to include the cost of the Report in the requested rate. As noted, we find that there was substantial and material evidence in the record to support the TRA's finding [*58] that the Booz Allen Report was inadequate because it did not sufficiently address whether the costs allocated to TAWC were incurred as a result of prudent management decisions. We hold the TRA did not abuse its discretion when it declined to accept the management fees requested by TAWC. We also find that as the Booz Allen Report could not be used by the TRA to determine whether the requested fees were prudent and necessary, the rate payers should not be required to pay for the cost of the Report. The TRA's disallowance of the cost of the report is affirmed.

TAWC claims, that in calculating revenues, the TRA departed from its long-standing practice by rejecting the use of a weather normalization adjustment (WNA) methodology based on data collected over an extended number of years without substantial and material evidence to justify the change. The Consumer Advocate, in its brief, explained "normalization" in the rate-making context: "In setting just and reasonable rates, it is standard practice to attempt to "normalize" or adjust projections of revenues and expenses for a variety of know and measurable changes. If such adjustments are not made, revenues and expenses may dramatically [*59] exceed or drastically fall short of expectations with a variety of consequences for consumers and TAWC." The revenues of a water utility can be effected by the amount of precipitation experienced in the utility's area. A drought may cause consumers to use more water for watering their lawns and a period of excessive rain may cause the consumers to use less water. In rate-making the forecasting of revenues is an essential element in the process. If revenues are projected to be lower in the future and expenses are expected to rise, the revenue requirement, and thus the rates, will be higher. Therefore, if water usage per customer is predicted to decrease, rates will need to be higher to cover expenses. Here, TAWC's proposed WNA methodology projected a reduction in revenue of approximately $1.3 million dollars.

As part of the 2008 Rate Case, TAWC introduced testimony from its expert witness, Dr. Edward Spitznagle, a professor

[4] The record does not establish whether a management audit was submitted within the six month period or, if one was presented to the TRA, or whether the management fees were adjusted.

of mathematics and statistics. Dr. Spitznagle explained that he tested several models for weather normalization and concluded that soil moisture was the most accurate predictor of future water consumption. Dr. Spitznagle employed a set of soil moisture data that was [*60] complied over the past thirty years to normalize the forecast and is set out in the Palmer Drought Severity Index (PDSI). The Company's projected attrition period Revenues was $37,142,460. The Consumer Advocate forecasted revenue for the attrition period at a higher level, $39,492,768 and made no normalizing adjustments. The TRA panel adopted attrition period revenues of $38,934,309 by using a combination of the Company's, the Consumer Advocate's, and its own forecast. In its Final Order, the TRA explained that it "found neither the Company's nor the Consumer Advocate's methodology for forecasting residential and commercial average usage persuasive and instead performed its own analysis, examining average usage trends for the residential and commercial classes over the four years ended March 31, 2005, 2006, 2007 and 2008." The TRA explained that it adopted residential class attrition period revenues based on this methodology and the Company's forecasted number of bills. For the commercial class, the TRA's analysis produced almost the identical result the TAWC had arrived at, thus it adopted the TAWC's commercial class attrition period forecasted revenue.

TAWC claims that TRA had consistently [*61] approved the use of weather normalization for forecasting revenue in prior rate cases. The TRA, however, rejected this claim explicitly in the Final Order when it stated:

> As to the weather normalization adjustment ("WNA"), the Company made representations that the model it used in forecasting residential and commercial average usage had be previously adopted by the Authority. Not withstanding an occasional concurrence by Intervenor witnesses, this assertion is incorrect. In earlier TAWC rate case dockets, Docket Nos. 03-00118 and 04-00288, TAWC's revenues were settled. Although the parties in those dockets settled on the amounts proposed by TAWC, the settlements did not mention any agreed upon methodology for calculating those revenues. The Company's revenue forecast was adopted in Docket No. 06-00290; however, the Authority did not adopt or endorse TAWC's WNA model. In this docket, the panel did not adopt the Company's entire revenue forecast or the Company's WNA model. Nevertheless, the Authority adopted the Company's commercial class attrition period revenue in this docket because despite disagreeing with the Company's methodology, the result was reasonable.

TAWC responds to the TRA's [*62] denial in the Final Order that it had "adopted" WNA methodology by stating that the TRA's incorporation of TAWC's WNAs into the orders approving settlement in Docket Nos. 03-00118 and 04-00288 and express adoption of TAWC's revenue adjustments in the 2006 Rate Case [Docket No. 06-00290] undermines the TRA's denial that it had adopted the WNA methodology. TAWC argues that "it is clear that the TRA has in practice routinely accepted and reinforced the use of WNA methodology in attrition year revenue projections, and the TRA's rejection of the WNA methodology in the instant matter departs from this precedent." TAWC goes on to claim, without citation to statute or case law, that under Tennessee law, the TRA may not alter its long-standing policy of using WNA for revenue projections unless there is substantial and material evidence supporting and justifying the decision. TAWC claims that the TRA did not make its decision to reject the methodology supported by TAWC based on substantial and material evidence and did not explain why it rejected the methodology. Tennessee law, however, does not provide that the TRA is bound to follow rate-making methodology it has employed in the past. The [*63] Tennessee Supreme Court discussed in detail the process of rate-making in *CF Indus. v. Tennessee Pub. Serv. Comm'n, 599 S.W.2d 536 (Tenn. 1980)* and explained why the TRA's predecessor, the Tennessee Public Service Commission, was not bound by any one rate-making methodology as follows:

> The criteria by which the Commission should be guided have received only generalized comments in our reported decisions. This is proper because the ***HN13*** courts are playing a limited role in reviewing actions which essentially are legislative in character. Rate making is not a judicial function and we accord the Commission great deference in reviewing its decisions. On fixing rates in general the Court has spoken in terms of what is just and reasonable "under the proven circumstances," of "regard to all relevant facts" and to a rate "in the zone of reasonableness." *Southern Bell Telephone & Telegraph Co. v. Tennessee Public Service Com'n., 202 Tenn. 465, 304 S.W.2d 640(1957)*.
>
> The Uniform Administrative Procedures Act authorizes the agency to take notice of "generally recognized technical and scientific facts within the agency's specialized knowledge," and in the evaluation of evidence the agency is specifically

[*64] authorized to utilize its "experience, technical competence, and specialized knowledge." Section 4-5-1097, T.C.A.

Thus, ***HN14*** the Public Service Commission in rate making and design cases is not solely governed by the proof although, of course, there must be an adequate evidentiary predicate. **The Commission, however, is not hamstrung by the naked record. It may consider all relevant circumstances shown by the record, all recognized technical and scientific facts pertinent to the issue under consideration and may superimpose upon the entire transaction its own expertise, technical competence and specialized knowledge. Thus focusing upon the issues, the Commission decides that which is just and reasonable. This is the litmus test nothing more, nothing less.**

In *United Inter-Mountain Telephone Co. v. Public Service Com'n*, 555 S.W.2d 389 (Tenn. 1977), this Court noted that ***HN15*** "(t)he impact of the Administrative Procedures Act on the review of the decisions made by state boards, commissions and agencies, including the Public Service Commission, is massive " (emphasis supplied), and pointed out that "(i)t casts upon the Commission the heavy burden of a sound, reasoned, and judicious approach in the [*65] exercise of its jurisdiction." *555 S.W.2d at 392*.

> We reiterate that neither the legislature nor the courts have established any precise formula or yardstick to guide the Commission. As pointed out by the Georgia Supreme Court in *Allied Chemical Corp. v. Georgia Power Co., 236 Ga. 548, 224 S.E.2d 396 (Ga. 1976)*: The process of setting rates is not required to follow any particular course, so long as the end result does not violate the "just and reasonable requirement" requirement . . . . *224 S.E.2d at 399*.

The Oklahoma Supreme Court, in Application of Arkansas Louisiana Gas Co., 1976 OK 192, 558 P.2d 376 (Okl.1976), pointed out:

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

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

> ***HN16*** (W)e [*66] must presume that the members of the commission itself, with their supporting staff, have in their grasp practical knowledge in the field of utilities regulation not possessed by either the courts or laymen in general.
>
> The commission, in order to carry out its mandate from the legislature to establish "just and reasonable" rates, must be able to draw on its own internal sources of knowledge and experience. As with the legislature itself, we assume that it does so in each instance and that we ought not to interfere unless it should clearly exceed its statutory powers. *251 N.W.2d at 354*.

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

CF Indus., 599 S.W.2d. at 542-43(emphasis added); *see also Powell Tel Co., 660 S.W.2d at 46*.

Based on the Supreme Court's pronouncements in *CF Industries*, ***HN17*** the TRA is not required to follow a particular methodology it has used in the past as long as the methodology it chooses allows it to arrive a determination of a rate that is just and reasonable. Moreover, [*67] the TRA is not limited to considering just what is in the record as it may consider, in addition to the proof, "recognized technical and scientific facts pertinent to the issue" and may "superimpose . . . its own expertise, technical competence and specialized knowledge."

TAWC's contention that the TRA must use WNA as part of its revenue projection methodology is without merit. The TRA is only required to use its regulatory judgment and exercise its discretion to decide what is a just and reasonable rate.

The TRA's rejection of TAWC's proposed use of WNA calculations is amply supported by material and substantial evidence in the record. The consistency and end result of the

proposed WNA was challenged by the intervenors, particularly the Consumer Advocate. Terry Buckner, testifying for the Consumer Advocate, explained that in the 2006 Rate Case, the impact of Dr. Spitznagle's WNA was a $221,000 downward adjustment to the projected revenue for the attrition year. This projection, when examined in retrospect, was incorrect as TAWC's revenues after the 2006 Rate Case actually increased. Mr. Buckner went on to explain that notwithstanding this result, a year later, Dr. Spitznagle's WNA revenue [*68] adjustment jumped downward again from $221,000 to $1.36 million in the 2008 Rate Case.

According to Mr. Buckner, after little more than updating the model to include a slightly different 30 year picture of PDSI data, the WNA's calculation resulted in a rate adjustment six times greater than the adjustment proposed in the 2006 Rate Case. *Id.*

The Consumer Advocate's witness also stated that the final result of the WNA model relied on by Dr. Spitznagle produced a result that defied common sense. His model calculated that residential consumers will use 141 gallons of water per day. Based on the WNA model's projections, TAWC would sell less water to residential customers than it did in 2004 when customers were estimated to use 146 gallons of water a day. According to PDSI data in the record, 2004 was the fourth wettest year in Chattanooga out of 113 years. Thus, the WNA model relied on by TAWC projected that the Company would sell less water under "normal weather conditions" than it did during one of the wettest years on record. The Consumer Advocate concluded that given that 2004 was an exceedingly wet year and that the record shows that TAWC was delivering water to 3,000 more residential [*69] customers in 2008 than it did in 2004, "the end result of Dr. Spitzenagel's WNA mode defies economic reality" and is not reasonable and credible.

Dr. Spitzenagel testified that while his WNA models had been used in three rate cases before the TRA filed since 2003, he had only reviewed the accuracy of these WNA forecasts by comparing them to the actual revenue for one of those years. A retrospective comparison of the models' results with the real revenues would have been a simple exercise to demonstrate the accuracy or inaccuracy of the Company's WNA forecasts. The record also shows that TAWC relied on Dr. Spitznagle's analysis that showed a marked decline in water usage over the past thirty years. However, the intervenors showed that, in fact, water usage over ten-year, five-year and three-year average periods show the decline in usage has ended.

Evidence was introduced at the hearing that called into question the value of the PDSI, the drought index employed by Dr. Spitznagle to calculate the WNA. In a publication by the National Academy of Sciences, the water regression analysis used by Dr. Spitznagle was addressed and the limitations of the use of the PDSI was noted with references [*70] to specific academic criticism of the PDSI. This publication was introduced into evidence and after the hearing, the TRA formally took administrative notice of the publication. There was further evidence in the record that the use of the PDSI for normalizing water usage by public utilities is not widespread.

When the TRA rejected the weather normalization methodology sponsored by TAWC, its decision was clearly supported by substantial and material evidence in the record. As explained in the Final Order, after considering the testimony of the expert witnesses presented by the parties, the TRA exercised its discretion and utilized its own experience, knowledge and expertise in its determination of the weather normalization adjustment to project revenues. The TRA conducted its own analysis based an examination of average usage trends for the residential and commercial classes over a four-year period. The years used in this analysis, 2005 - 2008, included periods of drought and high amounts of rainfall. The TRA's use of an average of usage trends over the four year period took into account the impact of weather as well as other impacting factors is accounted for and built into the consumer [*71] usage utilized in the analysis. The TRA took the results of this methodology and adopted normalized revenues for the residential customers that was independent of the forecasts proposed by both the Company and the Consumer Advocate. *Id.* The results arrived at by the TRA for the commercial customers was almost identical to that proposed by TAWC, thus the TRA adopted the Company's forecast for that class of consumers. *Id.* There was evidence to show that the methodology used by the TRA based on years of actual consumer usage is a common method of normalizing revenues for water utilities. Based on the foregoing, the methodology utilized by the TRA was a common and accepted practice, based on material and substantial evidence and was within the TRA's sound regulatory judgment.

TAWC contends that the TRA's decision to reduce the Company's recovery of Rate Case Expenses was an unlawful exercise of discretion and unsupported by material and substantial evidence. The Company argues that the award of $275,000, only half of its projected expenses, should be reversed because: (1) the decision represents a change in policy without substantial and material evidence to support the change; (2) the [*72] decision disregards the facts and circumstances of the case without providing any rationale or explanation that might lead a reasonable person to draw the

same conclusion; and (3) the decision violates *Tenn. Code Ann. § 65-5-103*'s "just and reasonable" standard by failing to take into consideration the estimated effect of reasonably expected expenses".

In support of its contention that the TRA departed from its usual policy and custom of allowing utilities recovery of rate case expenses, the Company cites to the following three cases where such an award was made. In the 2006 Rate Case, In *In re Aqua Utilities Co.*, and *In re Chattanooga Gas Co.*

TAWC contends that by disallowing one half of the Company's proposed rate case expenses, the TRA "made and abrupt and unexpected change in the sound policy of allowing full recovery of rate case expenses without any explanation or substantial and material evidentiary support for the change." TAWC further argues that the change in "policy" was particularly inappropriate because the TRA concluded that a rate increase was needed, although the approved increase was less than the Company had requested.

TAWC states that the expense of the rate case was [*73] reasonable, necessary and conservative given how highly contentious and heavily litigated the 2008 Rate Case was. We acknowledge that extensive discovery, multiple motions and multiple hearings occurred in the pre-hearing phase of the 2008 Rate Case. At the hearing itself multiple witnesses filed prepared testimony and testified before the panel. The record on appeal consists of sixty-two volumes and 9319 pages, the hearing transcript is contained in twenty-two volumes and is 2240 pages. We recognize and accept that this work was generated at considerable expense.

TAWC states that no substantial and material evidence was offered that the rate expenses sought were unreasonable and that the evidence offered by TAWC regarding the reasonableness of the expenses was not contradicted by any party. The Company cites the Consumer Advocate's witness, Mr. Buckner, as testifying that the number of issues being contested and the complexity of those issues necessarily increases the costs of rate cases.

On appeal, the TRA does not dispute that reasonable and properly incurred expenses associated with a rate case should be recoverable by a utility. In support of this concept, the TRA cites to *W. Ohio Gas Co. v. Pub. Utilities Comm'n of Ohio, 294 U.S. 63, 68, 55 S. Ct. 316, 319, 79 L. Ed. 761 (1935)* [*74] wherein the United States Supreme Court held that a public utility cannot include negligent or wasteful losses among its operating charges in a rate proceeding and only property and necessary expenses should be recovered. The TRA acknowledges that it is through the rates approved by the TRA and paid by the utility's customers that TAWC recovers all of its necessary operating expenses. However, TRA takes the position that the ability of a utility to recover its expenses is not "absolute nor immutable" and it is "neither arbitrary or capricious when, in the exercise of its judgment and discretion, the Authority disallows recovery of expenses that it deems unnecessary, improvident, or improper."

The TRA goes on to justify its decision to allow only one-half of the rate case expenses proposed by TAWC and leave the remaining half to be paid by the Company's shareholders by providing details of the costs of the "four labor-intensive utility cases [filed] in the five years spanning 2003 through 2008". According to the agency, the total requested rate case expenses associated with those four cases was $1,325 million although the actual expenses were estimated to be in excess of $1 million each [*75] for the 2006 and 2008 rate cases. The TRA, in its brief expresses its growing concern that TAWC has developed a distinct pattern of filing "increasingly frequent and progressively more costly rate cases . . . in rapid succession . . . . " The TRA states in its brief, "particularly in light of its poor history of substantiating the requests [for regulatory expenses] that it makes, demonstrating little restraint, the Company's expectation of passing on larger and larger rates case expenses year over year to its ratepayers, is inexplicable and untenable."

The TRA makes clear in its appellate brief that it disapproves of the TAWC's trend of filing frequent, increasingly expensive and litigious rate cases and even went as far as to contend that "in light of the Company's history and pattern of filing unsubstantiated rate cases, particularly evident in this case, the inordinate costs involved here are unreasonable. However, the record and Final Order are devoid of the foregoing accusations made by the TRA about TAWC. The record and Final Order do not explain what specific expenses the TRA deemed unnecessary, improvident, or improper or that the Authority closely examined the costs associated [*76] with the rate case to determine the portion to be recovered from rate payers and the portion to be born by the shareholders. Such an examination should have taken place and its results included in the record and Final Order. Based on the lack of such findings, the TRA's decision to only include one half of the cost of the rate case in the rate was arbitrary. Accordingly, we reverse the Commission of the TRA on this issue and award TAWC the full amount of its proposed rate case expenses.

Finally, the TAWC contends that the TRA'S decision to cap UfW at 15% was an abuse of discretion and unsupported by

material and substantial evidence. The Company takes the position that the TRA has historically taken into consideration all of TAWC's costs for fuel, power, and chemicals in determining TAWC's forecasted expenses. The Company explained that these costs directly relate to the treatment and pumping of all water in the distribution system whether it is water delivered and billed to customers or UfW. The Company states on appeal that TRA "has historically allowed TAWC to recoup the mil costs of treating and providing all of its water regardless of the volume of UfW in the system." TAWC claims [*77] that TRA "broke" from this historical policy in its final order when it capped the percentage of UfW it could include in the forecast for fuel, power and chemical costs to 15%. The Final Order states that "[r]ecognizing the importance of conserving water, which is one of the state's most valuable natural resources, the panel established a baseline efficiency standard. Based on the evidence presented, the panel limited the unaccounted-for-water percentage to fifteen percent." TAWC contends that the TRA could not have based this decision on the evidence as it clearly showed that TAWC's attrition year UfW would be 19.97% and that this level is reasonable based on the age of the water system and its geographical location in a mountainous area.

First, as to the historical precedent argument made by TAWC, while the TRA may not have ever set a 15% standard for UfW in a rate case brought by TAWC, it has recently imposed such a standard in other rate cases involving other TRA regulated water utilities. The Authority points to the 2006 rate case *In re Aqua Utilities Co.*, TRA Docket No. 06- 00187. In that case, while establishing a standard UfW percentage for ratemaking purposes, the panel said:

> Generally, [*78] the Authority finds a ten percent (10%) unaccounted-for-water level, as recommended by the American Water Works Association, is the proper percentage for purposes of setting rates, *absent good cause shown.* (Emphasis provided).

The TRA found that Aqua Utilities had shown good cause to increase the standard UfW percentage in that case to 15%. TRA claims that its decision in *Aqua* "pioneered" the Authority's policy concerning UfW and the reasonableness of utilizing a 15 % UfW standard was likewise included in a later settlement agreement between the parties in a rate case filed by Hickory Star Water Co., and approved by the TRA on December 30, 2008. [5]

The record demonstrates there was material and substantial evidence presented to the TRA regarding the use of the 15% standard. The president of TAWC, Mr. Martin, agreed that the 15% standard is used internally [*79] at TAWC and that it is a "good industry average." The TRA's use of the 15% UfW standard was based on material and substantial evidence and was not arbitrary. We affirm the TRA's order as to UfW.

In conclusion, we affirm the ruling of the TRA's except for its ruling excluding one-half of the expenses TAWC sought to recover as rate case expenses.

In our discretion we assess 80% of the costs of the appeal to Tennessee American Water Company, and 20% of the expenses on appeal to the Tennessee Regulatory Authority.

/s/ Herschel Pickens Franks

HERSCHEL PICKENS FRANKS, P.J.

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[5] *See In re Aqua Utilities Co.*, TRA Docket No. 06-00187, *Final Order*, 2007 WL 4812199 at *5 (Tenn. Reg. Auth. Nov. 27, 2007); *In re Petition of Hickory Star Water Co. LLC for Approval of Adjustment of its Rates and Charges*, TRA Docket No. 08-00051, *Order Approving Settlement Agreement*, Ex. A, Proposed Settlement Agreement (Dec. 30, 2008).

US LEC of Tenn., Inc. v. Tenn. Regulatory Auth.

Court of Appeals of Tennessee, at Nashville

May 4, 2005, Session ; April 17, 2006, Filed

No. M2004-01417-COA-R12-CV

Reporter
2006 Tenn. App. LEXIS 243; 2006 WL 1005134

US LEC OF TENNESSEE, INC. v. TENNESSEE REGULATORY AUTHORITY

Prior History: [*1] *Tenn. R. App. P. 12* Petition for Review; Judgment of the Tennessee Regulatory Authority Affirmed. Appeal from the Tennessee Regulatory Authority. No. 02-00562. Sara Kyle, Chairman.

Disposition: Judgment of the Tennessee Regulatory Authority Affirmed.

Core Terms

telecommunications service, services, telecommunications, statute's, provider, electric, courts, electric utility, cross-subsidy, certificate, customers, subsidy, convenience and necessity, cross-subsidization, unregulated, regulated, costs, hearing officer, conditions, activities, marketing, DICTIONARY, insisted, initial order, uncompensated, competitors, municipal, construe, words

Case Summary

Procedural Posture

Appellant privately owned telecommunications provider filed a complaint with the Tennessee Regulatory Authority asserting appellee competing provider owned by a municipal electric utility was receiving an illegal cross-subsidy in violation of *Tenn. Code Ann. § 7-52-402* (2005) because the utility was permitting the provider to use its name without compensation. A hearing officer held that there was no cross-subsidy. The private provider appealed.

Overview

The outcome of the appeal hinged on the scope of *§ 7-52-402*'s prohibition against a municipal electric system providing subsidies to its telecommunications services division. The authority and the competing provider claimed that the subsidies prohibited by *§ 7-52-402* were confined to the use of revenues from the sale of electricity to pay for costs of providing telecommunications services. The appellate court held that use of the electric utility's name was not a cross-subsidy prohibited by *§ 7-52-402*. The purpose of *§ 7-52-402* was to prevent municipal electric utilities who decided to provide telecommunications services from shifting the costs of providing telecommunications services to their electricity customers. The utility established its reputation long before its telecommunication's company began providing telecommunications services. When that company began operating, it was required to establish its own identity in the local telecommunications services market, and the record contained no evidence that the utility's electricity customers paid for any of those promotional costs. The record showed that the company actually used its own revenues to pay those costs.

Outcome

The judgment of the trial court was affirmed. The case was remanded. The costs of the appeal were taxed to the privately owned telecommunications provider.

LexisNexis® Headnotes

Civil Procedure > Appeals > Standards of Review > De Novo Review

Governments > Legislation > Interpretation

HN1 The search of the meaning of statutory language is a judicial function. While the courts must carefully consider an administrative agency's interpretation of the statutes it is charged to enforce, issues involving the construction of statutes involve questions of law. Accordingly, the courts must make their own independent determination regarding a statute's meaning without presuming that the agency's interpretation of the statute is correct.

Governments > Legislation > Interpretation

HN2 When the courts are called upon to construe a state statute, their primary responsibility is to ascertain and give effect to the intent and purpose of the Tennessee General Assembly. The courts must avoid constructions that unduly restrict or expand the statute's application. The goal is to construe a statute in a way that avoids conflict and facilitates the harmonious operation of the law.

Governments > Legislation > Interpretation

HN3 The search for a statute's purpose must begin with the words of the statute itself. The courts must construe statutes as they find them. The courts must also presume that the general assembly chose its words purposefully and deliberately, and that the words chosen by the general assembly convey the meaning that the general assembly intended them to convey.

Governments > Legislation > Interpretation

HN4 The courts must construe a statute's words using their natural and ordinary meaning unless the context in which the words are used requires otherwise. Because words are known by the company they keep, the courts should construe statutory language in the context of the entire statute and it light of the statute's general purpose. When the meaning of statutory language is clear, the courts must interpret the statute as written, rather than using the rules of construction to give the statute another meaning.

Governments > Legislation > Interpretation

HN5 Statutes, however, are not always free from ambiguity. When the courts encounter ambiguous statutory language, language that can reasonably have more than one meaning, they must look to the entire statute, the statutory scheme of which the statute is a part, and elsewhere to ascertain the general assembly's intent and purpose. The courts frequently find interpretive guidance in a statute's legislative history. The courts must, however, be cautious when they consult a statute's legislative history. A statute's meaning must be grounded in its text. Thus, comments made during the general assembly's debates cannot justify a construction of a statute that has no reference points in the text of the statute itself. When a statute's text and the comments made by legislators during the debates on the statute diverge, the text controls.

Governments > Legislation > Interpretation

HN6 While consulting a dictionary may be a helpful place to identify the possible meanings of a word or phrase, it is only the beginning of the search for legislative intent, not the end. Statutes should not be construed as if they are simply a series of definitions strung together. Once the possible meanings of a word or phrase have been identified, the courts should then narrow the possibilities by considering the context in which the word or phrase is used, the underlying facts, the legislative history, and prior decisions.

Communications Law > ... > Regulated Entities > Telephone Services > General Overview

Energy & Utilities Law > Utility Companies > General Overview

HN7 In its most general sense, the word "subsidy" refers to a grant or gift of money or other property made by way of financial aid. It is also commonly understood as a grant usually made by the government, to any enterprise whose promotion is considered to be in the public interest. In the context of regulated industries, a "subsidy" is a payment by the government or other entity to a producer in order to induce the producer to provide services otherwise thought to be unprofitable.

Communications Law > ... > Regulated Entities > Telephone Services > General Overview

Energy & Utilities Law > Utility Companies > General Overview

HN8 With regard to the regulated services, a subsidy involves an external flow of cash from an outside source. The internal flow of cash from one division of an enterprise to another is referred to as a "cross-subsidy." A cross-subsidy occurs when an enterprise uses the revenues from the sale of one service to offset its cost to produce and sell another service.

Communications Law > ... > Regulated Entities > Telephone Services > General Overview

Energy & Utilities Law > Utility Companies > Rates > General Overview

HN9 Cross-subsidies are not commonplace in unregulated markets. They are not profit maximizing, and thus enterprises providing unregulated services have little incentive to cross-subsidize. However, incentives to cross-subsidize arise when an enterprise provides services in both regulated and unregulated markets. In that circumstance, the enterprise may seek to lower the price of the service in the unregulated market by allocating a portion of its costs of providing the service to its costs of providing the regulated service.

Antitrust & Trade Law > Regulated Practices > Price Fixing & Restraints of Trade > General Overview

Communications Law > ... > Regulated Entities > Telephone Services > General Overview

Energy & Utilities Law > Utility Companies > Rates > General Overview

HN10 The use of revenues from the sale of services in a regulated market to subsidize the cost of providing the services in the unregulated market is a cross-subsidy. The practice is anti-competitive and produces two negative effects. First, it results in the enterprise's customers in the regulated market being overcharged for their services because they are paying the cost of the subsidy of the unregulated service. Second, the enterprise engaging in cross-subsidization gains an unfair competitive advantage in the unregulated market because the cross-subsidy enables the enterprise to provide the unregulated service below its actual cost.

Communications Law > ... > Regulated Entities > Telephone Services > General Overview

Energy & Utilities Law > Utility Companies > General Overview

Governments > Local Governments > Duties & Powers

HN11 The purpose of *Tenn. Code Ann. § 7-52-402* is to prevent municipal electric utilities who decide to provide telecommunications services from shifting the costs of providing telecommunications services to their electricity customers.

Counsel: Henry M. Walker and Kristy R. Godsey, Nashville, Tennessee, for the appellant, US LEC of Tennessee, Inc.

Carlos C. Smith and Mark W. Smith, Chattanooga, Tennessee, for the appellee, Electric Power Board of Chattanooga.

J. Richard Collier, Carolyn E. Reed, and Randall Gilliam, Nashville, Tennessee, for the appellee, Tennessee Regulatory Authority.

Judges: WILLIAM C. KOCH, JR., P.J., M.S., delivered the opinion of the court, in which PATRICIA J. COTTRELL and FRANK G. CLEMENT, JR., JJ., joined.

Opinion by: WILLIAM C. KOCH, JR.

Opinion

This appeal involves a dispute between two telecommunications services providers in the Chattanooga market. A privately owned provider filed a complaint with the Tennessee Regulatory Authority asserting that a competing provider owned by a municipal electric utility was receiving an illegal cross-subsidy because the electric utility was permitting the provider to use its name without compensation. One of the Authority's [*2] hearing officers conducted a hearing and then filed an initial order concluding that the provider owned by the electric utility was not receiving a cross-subsidy in violation of *Tenn. Code Ann. § 7-52-402* (2005). After the initial order became final, the private provider filed a *Tenn. R. App. P. 12* petition for review with this court. We have concluded that the provider's uncompensated use of the electric utility's name is not a cross-subsidy prohibited by *Tenn. Code Ann. § 7-52-402*.

OPINION

I.

The Electric Power Board of Chattanooga (EPB) was created by private act in 1935. [1] It provides electric power to both business and residential customers in the City of Chattanooga, most of Hamilton County, and parts of eight other Tennessee counties and North Georgia. In October 1997, after the Tennessee General Assembly, following Congress's lead, authorized municipal electric utilities to begin offering telecommunications services, [2] EPB applied to the Tennessee Regulatory Authority (Authority) for a certificate of convenience and necessity to enable it to begin providing telecommunications services through a telecommunications [*3] division that would be separate from EPB's electric utility system.

Because EPB's application was the first of its kind in Tennessee, the Authority convened a contested case proceeding to consider its application for a certificate of convenience and necessity. Eight entities intervened in the proceeding, including the Consumer Advocate Division of the Office of the Attorney General and Reporter, BellSouth Telecommunications, Inc., AT&T Communications of the Southern States, Inc., and the Tennessee Cable Telecommunications Association (TCTA). US LEC of Tennessee, Inc. (US LEC), a North Carolina telecommunications services provider doing business in the

[1] Act of Apr. 15, 1935, ch. 455, 1935 Tenn. Priv. Acts 1125.

[2] Act of May 27, 1997, ch. 531, 1997 Tenn. Pub. Acts 963 (codified at Tenn. Code Ann. §§ 7-52-401, -407 (2005)).

Chattanooga market, did not intervene. From the outset, EPB made it clear that it intended to operate its telecommunications division under its own name, and [*4] the intervenors likewise made it clear that they were equally insistent that EPB's electric utility system should not cross-subsidize its telecommunications division.

The TCTA led the opposition to EPB's application for a certificate of convenience and necessity. One of TCTA's experts recognized that, unlike other new entrants into the local telecommunications services market, EPB had a "substantial amount of goodwill and name recognition developed with those electric ratepayers." To address TCTA's concerns about the cross-subsidization prohibited by *Tenn. Code Ann. § 7-52-402*, the TCTA and EPB negotiated and filed with the Authority a detailed set of conditions on EPB's certificate that were intended to ensure compliance with *Tenn. Code Ann. § 7-52-402*. [3]

By their own terms, these conditions [*5] formed "the essential methods that EPB should adopt to properly separate telecommunications from electric power accounting data, [to] provide assurance that cross-subsidization does not occur, and to properly allocate cost." The conditions recognized that EPB would provide telecommunications services through a discrete telecommunications services division, that the revenues and expenses of the telecommunications services division would be segregated from those of the electric utility system, and that the two entities would acquire services from each other at the rates charged other customers. They also provided a "general allocator" for expenses that could not be directly allocated. With specific regard to joint marketing, the conditions included a Code of Conduct providing that:

> The electric system and the telecommunications division of the Electric Power Board of Chattanooga may jointly offer their respective products and services to customers provided that the customer is informed (a) of the separate identities of each and (b) that the products and services of the electric utility system are distinct and separately priced from the offerings of the telephone division and [*6] the customer may select one without the other.

On May 10, 1999, the Authority granted EPB a certificate of convenience and necessity, and "EPB Telecom" began providing telecommunications services to local businesses in April 2000.

On May 15, 2002, US LEC filed a complaint with the Authority alleging that EPB was engaging in discriminatory and anti-competitive business practices. It complained that EPB was allowing EPB Telecom to use EPB's name, that EPB was granting EPB Telecom access to buildings that it was not granting to other telecommunications providers, and that EPB had failed to file its annual audits with the Authority. BellSouth Telecommunications, Inc. intervened in the proceeding, and in June 2002, the Authority referred the matter to a hearing officer for disposition. Three months later, US LEC filed an amendment to its complaint containing a fourth allegation - that EPB Telecom had refused to allow US LEC to interconnect with EPB Telecom's network or to provide certain unbundled services.

The hearing officer later concluded that US LEC did not have standing to take issue with EPB Telecom's failure to file its annual audits, and the parties informally resolved [*7] US LEC's building access and network interconnection and unbundled services claims. Thus, the only remaining issue involved US LEC's claim that EPB's marketing and advertising activities violated the anti-subsidization provisions in *Tenn. Code Ann. § 7-52-402* or the Code of Conduct agreed upon by EPB and the TCTA.

The hearing officer conducted hearings on February 25 and March 16, 2004. During these hearings, US LEC presented evidence that EPB's name was instantly recognizable and that it had value because of the company's reputation for quality and goodwill with its customers. It also presented evidence purporting to demonstrate that EPB was intentionally blurring the lines between its electric utility system and EPB Telecom. US LEC cited various sales tactics, joint marketing activities, press releases, and the EPB website as evidence of the manner in which EPB had allowed EPB Telecom to leverage EPB's name and insisted that these activities violated the Code of Conduct and *Tenn. Code Ann. § 7-52-402*. For its part, EPB insisted that its conduct was consistent with both the Code of Conduct and *Tenn. Code Ann. § 7-52-402* [*8] .

In its post-hearing brief, US LEC insisted that joint marketing provisions in the Code of Conduct should be clarified and strengthened. It argued that EPB Telecom should be required either to pay EPB for the use of its name or to operate using a name that did not indicate a relationship with EPB. Because of the difficulties in quantifying the benefit that

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[3] The Authority had requested the TCTA and EPB to confer about the issues raised regarding EPB's compliance with Tenn. Code Ann. § 7-52-402.

EPB Telecom derives from its use of the EPB name, US LEC argued that requiring EPB Telecom to change its name would be more appropriate and that changing EPB Telecom's name would not pose an undue hardship on EPB Telecom because name changes are common in the telecommunications industry.

The hearing officer filed an initial order on May 6, 2004. Despite her conclusion that US LEC lacked standing to challenge EPB's advertising and marketing activities, [4] the hearing officer invoked the Authority's general supervisory and regulatory power under *Tenn. Code Ann. § 65-4-104* (2004) as authority to address US LEC's complaints about EPB's and EPB Telecom's conduct. The hearing officer then concluded that EPB Telecom's uncompensated use of the EPB name was not a subsidy prohibited by *Tenn. Code Ann. § 7-52-402* [*9] and that neither EPB nor EPB Telecom had violated the Code of Conduct. US LEC did not request the Authority to review the initial order, and so the initial order became the Authority's final order by operation of law on May 21, 2004. US LEC thereafter filed a *Tenn. R. App. P. 12* petition for review on June 8, 2004.

II.

EPB'S ALLEGED VIOLATION OF TENN. CODE ANN. § 7-52-402

The outcome of this appeal hinges on the scope of *Tenn. Code Ann. § 7-52-402*'s prohibition against a municipal electric system providing subsidies to its telecommunications services division. US LEC insists that EPB Telecom's uncompensated use of EPB's name is a subsidy prohibited by *Tenn. Code Ann. § 7-52-402*. The Authority [*10] and EPB respond that the subsidies prohibited by *Tenn. Code Ann. § 7-52-402* are confined to the use of revenues from the sale of electricity to pay for costs of providing telecommunications services. These arguments require the court to focus first on the meaning of the word "subsidies" as it is used in *Tenn. Code Ann. § 7-52-402*.

A.

HN1 The search of the meaning of statutory language is a judicial function. *Roseman v. Roseman, 890 S.W.2d 27, 29 (Tenn. 1994)*; *BellSouth Telecomms., Inc. v. Greer, 972 S.W.2d 663, 672 (Tenn. Ct. App. 1997)*. While the courts must carefully consider an administrative agency's interpretation of the statutes it is charged to enforce, *State ex rel. Pope v. U.S. Fire Ins. Co., 145 S.W.3d 529, 536 (Tenn. 2004)*; *Exxon Corp. v. Metropolitan Gov't, 72 S.W.3d 638, 641 (Tenn. 2002)*, issues involving the construction of statutes involve questions of law. *Sallee v. Barrett, 171 S.W.3d 822, 825 (Tenn. 2005)*; *Memphis Publ'g Co. v. Cherokee Children and Family Servs., Inc., 87 S.W.3d 67, 74 (Tenn. 2002)*. Accordingly, [*11] the courts must make their own independent determination regarding a statute's meaning without presuming that the agency's interpretation of the statute is correct. *Bostic v. Dalton, 158 S.W.3d 347, 350 (Tenn. 2005)*; *Patterson v. Tenn. Dep't of Labor & Workforce Dev., 60 S.W.3d 60, 62 (Tenn. 2001)*.

HN2 When the courts are called upon to construe a state statute, their primary responsibility is to ascertain and give effect to the intent and purpose of the Tennessee General Assembly. *Freeman Indus., LLC v. Eastman Chem. Co., 172 S.W.3d 512, 522 (Tenn. 2005)*; *Sullivan ex rel. Hightower v. Edwards Oil Co., 141 S.W.3d 544, 547 (Tenn. 2004)*. The courts must avoid constructions that unduly restrict or expand the statute's application. *Sallee v. Barrett, 171 S.W.3d at 828*; *Watt v. Lumbermens Mut. Cas. Ins. Co., 62 S.W.3d 123, 127-28 (Tenn. 2001)*. The goal is to construe a statute in a way that avoids conflict and facilitates the harmonious operation of the law. *In re C.K.G., 173 S.W.3d 714, 729 (Tenn. 2005)*; *Frye v. Blue Ridge Neuroscience Ctr., P.C., 70 S.W.3d 710, 716 (Tenn. 2002)*. [*12]

HN3 The search for a statute's purpose must begin with the words of the statute itself. *Calaway ex rel. Calaway v. Schucker, S.W.3d , , 2006 Tenn. LEXIS 179, 2005 WL 3338655, at *5 (Tenn. 2006)*; *Biscan v. Brown, 160 S.W.3d 462, 470 (Tenn. 2005)*. The courts must construe statutes as they find them. *Jackson v. Jackson, 186 Tenn. 337, 342, 210 S.W.2d 332, 334 (1948)*; *Pac. Eastern Corp. v. Gulf Life Holding Co., 902 S.W.2d 946, 954 (Tenn. Ct. App. 1995)*. The courts must also presume that the General Assembly chose its words purposefully and deliberately, *Eastman Chem. Co. v. Johnson, 151 S.W.3d 503, 507 (Tenn. 2004)*; *Merrimack Mut. Fire Ins. Co. v. Batts, 59 S.W.3d 142, 151 (Tenn. Ct. App. 2001)*, and that the words chosen by the General Assembly convey the meaning that the General Assembly intended them to convey. *Biscan v. Brown, 160 S.W.3d at 473*; *Jones v. Garrett, 92 S.W.3d 835, 839 (Tenn. 2002)*.

HN4 The courts must construe a statute's words using their natural and ordinary meaning unless the context in which the words [*13] are used requires otherwise. *Tenn. Waste Movers, Inc. v. Loudon, 160 S.W.3d 517, 519 (Tenn. 2005)*;

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[4] The hearing officer concluded that US LEC lacked standing because it had failed to present any evidence that US LEC or any other telecommunications services provider had been adversely affected by EPB's or EPB Telecom's conduct.

Frazier v. East Tennessee Baptist Hosp., Inc., 55 S.W.3d 925, 928 (Tenn. 2001). Because words are known by the company they keep, *In re Audrey S., 182 S.W.3d 838, 870 (Tenn. Ct. App. 2005)*, the courts should construe statutory language in the context of the entire statute and it light of the statute's general purpose. *Honsa v. Tombigbee Transp. Corp., 141 S.W.3d 540, 542 (Tenn. 2004)*; *Osborn v. Marr, 127 S.W.3d 737, 740 (Tenn. 2004)*. When the meaning of statutory language is clear, the courts must interpret the statute as written, *Kradel v. Piper Indus., Inc., 60 S.W.3d 744, 749 (Tenn. 2001)*, rather than using the rules of construction to give the statute another meaning. *Wausau Ins. Co. v. Dorsett, 172 S.W.3d 538, 543 (Tenn. 2005)*; *Poper ex rel. Poper v. Rollins, 90 S.W.3d 682, 684 (Tenn. 2002)*; *Limbaugh v. Coffee Med. Ctr., 59 S.W.3d 73, 83 (Tenn. 2001)*.

HN5 Statutes, however, are not always free from ambiguity. When the courts encounter [*14] ambiguous statutory language - language that can reasonably have more than one meaning [5] - they must look to the entire statute, the statutory scheme of which the statute is a part, and elsewhere to ascertain the General Assembly's intent and purpose. *Sallee v. Barrett, 171 S.W.3d at 828*; *Eastman Chem. Co. v. Johnson, 151 S.W.3d at 507*; *Perrin v. Gaylord Entm't Co., 120 S.W.3d 823, 826 (Tenn. 2003)*. The courts frequently find interpretive guidance in a statute's legislative history. *State ex rel. Pope v. U.S. Fire Ins. Co., 145 S.W.3d at 535*; *Galloway v. Liberty Mut. Ins. Co., 137 S.W.3d 568, 570 (Tenn. 2004)*. The courts must, however, be cautious when they consult a statute's legislative history. *BellSouth Telecomms., Inc. v. Greer*, 972 S.W.2d at 673. A statute's meaning must be grounded in its text. Thus, comments made during the General Assembly's debates cannot justify a construction of a statute that has no reference points in the text of the statute itself. *D. Canale & Co. v. Celauro*, 765 S.W.2d 736, 738 (Tenn. 1989); *Townes v. Sunbeam Oster Co., 50 S.W.3d 446, 453 n.6 (Tenn. Ct. App. 2001)*. [*15] When a statute's text and the comments made by legislators during the debates on the statute diverge, the text controls. *BellSouth Telecomms., Inc. v. Greer*, 972 S.W.2d at 674.

B.

Our task in this case is not limited to picking the most appropriate dictionary definition of the word "subsidies." Rather, it is to ascertain the General Assembly's purpose for enacting *Tenn. Code Ann. § 7-52-402*. ***HN6*** While consulting a dictionary may be a helpful place to identify the possible meanings of a word or phrase, it is only the beginning of the search for legislative intent, not the end. Statutes should not be construed as if they are simply a series of Webster's definitions strung together. *See* LIEF H. CARTER & THOMAS F. BURKE, REASON IN LAW (6th ed. 2002). Once the possible meanings of a word or phrase [*16] have been identified, the courts should then narrow the possibilities by considering the context in which the word or phrase is used, the underlying facts, the legislative history, and prior decisions. REED DICKERSON, THE INTERPRETATION AND APPLICATION OF STATUTES 103 & n.2, 105 (1975); Samuel A. Thumma & Jeffrey L. Kirchmeier, *The Lexicon Has Become a Fortress: The United States Supreme Court's Use of Dictionaries*, *47 Buff. L. Rev. 227, 296 (1999)*.

HN7 In its most general sense, the word "subsidy" refers to "a grant or gift of money or other property made by way of financial aid." [6] [*17] It is also commonly understood as a "grant usually made by the government, to any enterprise whose promotion is considered to be in the public interest." [7] In the context of regulated industries, a "subsidy" is a payment by the government or other entity to a producer in order to induce the producer to provide services otherwise thought to be unprofitable. Gerald R. Faulhaber, *Cross-Subsidy Analysis With More Than Two Services*, 1 J. Competition L. & Econ. 441, 442 (2005) ("Faulhaber").

HN8 With regard to the regulated services, a subsidy involves an external flow of cash from an outside source. Faulhaber, 1 J. Competition L. & Econ., at 442. The internal flow of cash from one division of an enterprise to another is referred to as a "cross-subsidy." Faulhaber, 1 J. Competition L. & Econ., at 442. A cross-subsidy occurs when an enterprise uses the revenues from the sale of one service to offset its cost to produce and sell another service. *See Alliant Energy Corp. v. Bie, 330 F.3d 904, 917 (7th Cir. 2003)*; *see also In re Implementation of the Telecommunications Act of 1996: Accounting Safeguards Under the Telecommunications Act of 1996*, *11 F.C.C.R. 17539, 17542 n.4 (1996)*.

HN9 Cross-subsidies are not commonplace in unregulated markets. They are not profit maximizing, and thus enterprises

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[5] *LeTellier v. LeTellier*, 40 S.W.3d 490, 498 (Tenn. 2001); *Bryant v. HCA Health Servs. of N. Tenn., Inc.*, 15 S.W.3d 804, 809 (Tenn. 2000).

[6] WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 2279 (1971).

[7] BLACK'S LAW DICTIONARY 1469 (8th ed. 2004); *see also* XVII THE OXFORD ENGLISH DICTIONARY 60 (1989).

providing unregulated services have little incentive to cross-subsidize. [8] However, incentives to cross-subsidize arise when an enterprise provides services in [*18] both regulated and unregulated markets. In that circumstance, the enterprise may seek to lower the price of the service in the unregulated market by allocating a portion of its costs of providing the service to its costs of providing the regulated service. *GTE Midwest, Inc. v. F.C.C., 233 F.3d 341, 344 n.1 (6th Cir. 2000)* (defining cross-subsidization as "the misattribution of costs incurred in providing unregulated services to the provision of regulated services"); *California v. F.C.C., 39 F.3d 919, 926 (9th Cir. 1994)*; *Ameritech Corp. v. United States, 867 F. Supp. 721, 726 (N.D. Ill. 1994)*; *Florida Cable Television Ass'n v. Deason, 635 So. 2d 14, 15 n.2 (Fla. 1994)*.

[*19] ***HN10*** The use of revenues from the sale of services in a regulated market to subsidize the cost of providing the services in the unregulated market is a cross-subsidy. The practice is anti-competitive and produces two negative effects. First, it results in the enterprise's customers in the regulated market being overcharged for their services because they are paying the cost of the subsidy of the unregulated service. Second, the enterprise engaging in cross-subsidization gains an unfair competitive advantage in the unregulated market because the cross-subsidy enables the enterprise to provide the unregulated service below its actual cost. *In re Complaint of MCTA, 241 Mich. App. 344, 615 N.W.2d 255, 266 (Mich. Ct. App. 2000)*.

The legislators' discussions both in committee and during floor debate regarding *Tenn. Code Ann. § 7-52-402* reveal that cross-subsidization was their chief concern with regard to permitting municipal electric utilities to begin providing local telecommunications services in competition with privately owned providers. The bill's supporters emphasized that competition in the local telecommunications market was important and that electric utilities [*20] providing telecommunications services would not be permitted to use "rate dollars" to subsidize their telecommunications business. Accordingly, we have concluded that ***HN11*** the purpose of *Tenn. Code Ann. § 7-52-402* is to prevent municipal electric utilities who decide to provide telecommunications services from shifting the costs of providing telecommunications services to their electricity customers.

This record contains no evidence to support a conclusion that the uncompensated use of EPB's name is a subsidy prohibited by *Tenn. Code Ann. § 7-52-402*. EPB established its reputation long before EPB Telecom began providing telecommunications services. When EPB Telecom began operating, it was required to establish its own identity in the local telecommunications services market, and the record contains no evidence that EPB's electricity customers have paid for any of these promotional costs. To the contrary, the record contains substantial and material evidence supporting the hearing officer's conclusion that EPB Telecom has used its own revenues to pay these costs. Accordingly, we concur with the hearing officer's conclusion that US [*21] LEC failed to prove that EPB Telecom's use of EPB's name violates *Tenn. Code Ann. § 7-52-402*.

III.

EPB'S ALLEGED VIOLATION OF THE CODE OF CONDUCT

US LEC also insists that EPB's and EPB Telecom's joint marketing activities go beyond the scope of activities permitted by the Code of Conduct that was part of EPB's 1999 certificate of convenience and necessity. It also asserts that the Code of Conduct did not go far enough in protecting EPB Telecom's competitors against marketing practices that would give EPB Telecom an unfair advantage in the telecommunications services marketplace. We find no basis for these claims.

When EPB applied for a certificate of convenience and necessity to provide telecommunications services, its future competitors were well aware of the dangers of cross-subsidization. Accordingly, the Authority directed EPB and the other providers of telecommunications services in the Chattanooga market to negotiate a set of conditions that would ensure compliance with *Tenn. Code Ann. § 7-52-402*. These conditions contained specific accounting requirements

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[8] As Professor Faulhaber explains:

> Under competitive conditions, the issue of cross-subsidy simply does not arise. Firms with constant returns to scale technology compete in markets so that price is driven to marginal cost which covers total cost. Every product pays its own way; if it did not, there would be profitable opportunities for entry and repricing. Customers of any product or service who faced prices that forced them to pay too much . . . would soon find competitors willing to offer equivalent service at lower prices. The competitive market would police cross-subsidy, without need of a regulator.

Faulhaber, 1 J. Competition L. & Econ., at 442.

that would enable the Authority and EPB's competitors [*22] to track EPB Telecom's revenues and costs, as well as specific requirements for the relationship between EPB and EPB Telecom. They permitted joint marketing of regulated and unregulated services as along as EPB and EPB Telecom maintained their separate identities and refrained from bundling their services.

US LEC presented a substantial amount of evidence regarding the joint marketing activities of EPB and EPB Telecom. This evidence included sales brochures, press releases, the EPB website, and a booth at a Chattanooga business fair. All this evidence reveals that EPB and EPB Telecom continue to maintain their separate identities and are refraining from bundling their services. There is likewise no evidence that EPB Telecom has not paid its share of the costs of these activities or that EPB's electricity customers are paying for any of the costs that are properly attributable to EPB Telecom. Thus, we agree with the hearing officer's conclusion that US LEC failed to prove that EPB has violated the conditions of its certificate of convenience and necessity designed to prevent cross-subsidization.

As a final matter, US LEC insists that the conditions on EPB's certificate of convenience [*23] and necessity do not go far enough to protect EPB Telecom's competitors from unfair or anti-competitive practices. It argues that the only feasible way to protect competition in the Chattanooga telecommunications services market is to require EPB Telecom to discontinue using EPB's name. We have determined that the hearing officer correctly concluded that this proposed remedy was far more drastic than the attenuated competitive impact of EPB Telecom's use of EPB's name may have on the telecommunications services market in Chattanooga.

EPB was the only entity permitted to apply for the certificate of convenience and necessity under *Tenn. Code Ann. § 7-52-401*. From the outset, it was clear that EPB intended to provide telecommunications services through a separate but wholly-owned division. The Authority granted the certificate of convenience and necessity to provide telecommunications services to EPB. Thus, EPB's decision to name its telecommunications division "EPB Telecom" is entirely truthful and reflects the reality that EPB Telecom is part of EPB. US LEC failed to produce any evidence that the use of the name "EPB Telecom" has had any measurable anti-competitive [*24] effect in the marketplace for telecommunications services in the Chattanooga area. Without this evidence, and because of the potential adverse effect of depriving consumers of truthful information regarding EPB Telecom's affiliation, [9] we conclude that the record lacks any factual basis that would have required the Authority to order EPB Telecom to discontinue the use of EPB's name.

IV.

We affirm the Authority's order concluding [*25] that EPB Telecom's uncompensated use of EPB's name does not violate *Tenn. Code Ann. § 7-52-402* and denying all of US LEC's requests for relief. The case is remanded to the Tennessee Regulatory Authority for whatever further proceedings may be required, and the costs of this appeal are taxed to US LEC of Tennessee, Inc. for which execution, if necessary, may issue.

WILLIAM C. KOCH, JR., P.J., M.S.

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[9] EPB introduced two articles concluding that name and logo restrictions such as the one suggested by US LEC in this case could harm consumers by depriving them of truthful information regarding with whom they are dealing. Charles J. Ogletree, Jr., et al., *Utility Affiliates: Why Restrict Use of Names and Logos?*, Pub. Util. Fort., July 15, 1999, at 34; Kenneth Gordon & Charles Augustine, *Fostering Efficient Competition in the Retail Electric Industry: How Can Regulators Help Solve Vertical Market Power Concerns? First, Do No Harm* 20-23 (Edison Elec. Inst. Aug. 1998).

Avenell v. Gibson

Court of Appeals of Tennessee, at Knoxville

December 9, 2004, Session ; February 28, 2005, Filed

No. E2004-01620-COA-R3-CV

Reporter
2005 Tenn. App. LEXIS 121; 2005 WL 458733

CHRISTA A. AVENELL v. JAMES ALLEN GIBSON

Prior History: [*1] *Tenn. R. App. P. 3* Appeal as of Right; Judgment of the Chancery Court Reversed; Case Remanded. Appeal from the Chancery Court for Blount County. No. 03-046. Telford E. Forgety, Jr., Chancellor.

Disposition: Reversed and remanded.

Core Terms

funds, depositor, spouse, entirety, bank account, non-debtor, married, tenancy by the entirety, parties, levy, rights, trial court, deposits, joint account, ownership, separate action, garnished, right of survivorship, savings account, joint tenancy, instant case, sole owner, entitlement, levied-upon, commencing

Case Summary

Procedural Posture

Appellant wife brought an action against appellee, her husband's creditor, seeking to recover funds taken out of the couple's two joint accounts by their bank in response to a levy of execution. The Chancery Court for Blount County (Tennessee) held that the 1988 amendment to *Tenn. Code Ann. § 45-2-703* (2000) changed the law with respect to bank accounts and that the creditor was entitled to retain the funds. The wife appealed.

Overview

The dispositive issue was whether *Tenn. Code Ann. § 45-2-703(a)*, as amended in 1988, changed the long-standing law in Tennessee with respect to bank accounts held by married parties as tenants by the entirety. The court held that the legislative history reflected that the legislature did not intend to make a "substantive change" in the law with respect to tenancy by the entirety. The present version of the statute applied broadly to all deposits in the names of two or more persons, payable to either, or survivor and included any balance held by spouses. When a bank received a garnishment or execution arising out of a claim of any creditor of either depositor, the bank had to respond as if such depositor were the sole owner of the funds. That was what the bank did in the instant case. It paid monies from the two accounts into court as if the husband were the sole owner of the funds. Because the wife proved that the funds garnished by the creditor were taken from an account held by the parties as tenants by the entirety and that she and the debtor were married, she was entitled to a dismissal of the levy of execution and a release of the funds.

Outcome

The judgment of the trial court was reversed and the case was remanded with directions to dismiss the levy of execution and to release the funds to the order of the couple.

LexisNexis® Headnotes

Civil Procedure > Trials > Bench Trials

Civil Procedure > Appeals > Standards of Review > De Novo Review

Civil Procedure > Appeals > Standards of Review > Questions of Fact & Law

Evidence > Inferences & Presumptions > General Overview

HN1 In a non-jury case, review is de novo upon the record of the proceedings below; but the record comes to the appellate court with a presumption of correctness as to the trial court's factual findings that the appellate court must honor unless the preponderance of the evidence is otherwise. Tenn. R. App. P. 13(d). The trial court's conclusions of law, however, are accorded no such presumption.

Governments > Legislation > Interpretation

HN2 An appellate court's duty in construing statutes is to ascertain and give effect to the intention and purpose of the legislature.

Contracts Law > Personal Property

Family Law > ... > Property Distribution > Characterization > Marital Property

Governments > Legislation > Enactment

Real Property Law > Estates > Concurrent Ownership > General Overview

Real Property Law > Estates > Concurrent Ownership > Tenancies by Entireties

HN3 Tenancy by the entirety is a form of property ownership unique to married persons, and the ability of married persons to hold property as tenants by the entirety is well-established in Tennessee. When the statute emancipating married women was enacted in 1913, *Tenn. Code Ann. § 36-3-504* (2001), the Supreme Court of Tennessee initially held that the statute had abolished the concept of tenancy by the entirety. However, in 1919, the legislature enacted legislation, now codified at *Tenn. Code Ann. § 36-3-505* (2001), which expressly states that nothing in the emancipation statute shall be construed as abolishing tenancies by the entirety. Thus, with the exception of the six-year period from 1913 to 1919, tenancy by the entirety has been a recognized form of property ownership in Tennessee for over a century.

Banking Law > ... > Bank Accounts > Deposit Accounts > General Overview

Banking Law > ... > Deposit Account Types > Joint Accounts > Tenancies by Entireties

Contracts Law > Personal Property

Real Property Law > Estates > Concurrent Ownership > General Overview

Real Property Law > Estates > Concurrent Ownership > Tenancies by Entireties

HN4 When married individuals hold property as tenants by the entirety, each spouse is seized of the whole or the entirety and not of a share, moiety, or divisible part. The rule in Tennessee has long been that personal property, as well as realty, may be held by spouses by the entirety. Ownership by the entirety may extend to bank accounts.

Banking Law > ... > Bank Accounts > Deposit Accounts > General Overview

Banking Law > ... > Deposit Account Types > Joint Accounts > Joint Tenancies

Banking Law > ... > Deposit Account Types > Joint Accounts > Tenancies by Entireties

Contracts Law > ... > Negotiable Instruments > Enforcement > Joint & Several Instruments

Contracts Law > Personal Property

Real Property Law > Estates > Concurrent Ownership > Tenancies by Entireties

Real Property Law > Estates > Concurrent Ownership > Tenancies in Common

HN5 The words of a conveyance or legal instrument which would make two other persons joint tenants under the common law, or tenants in common under what is now *Tenn. Code Ann. § 66-1-107*, will create tenancy by the entirety in a husband and wife. Further, there is an abundance of authority in Tennessee holding that the use of the word "or" between the names of spouses on a bank account or negotiable instrument does not preclude their ownership of the asset by the entirety.

Banking Law > ... > Bank Accounts > Deposit Accounts > General Overview

Contracts Law > Personal Property

HN6 See former *Tenn. Code Ann. § 45-2-703(a)* (1980).

Banking Law > ... > Bank Accounts > Deposit Accounts > General Overview

Banking Law > ... > Deposit Account Types > Joint Accounts > Tenancies by Entireties

Contracts Law > Personal Property

Governments > Legislation > Effect & Operation > Amendments

Governments > Legislation > Interpretation

Real Property Law > Estates > Concurrent Ownership > General Overview

Real Property Law > Estates > Concurrent Ownership > Tenancies by Entireties

HN7 Former *Tenn. Code Ann. § 45-2-703(a)* (1980) was part of a major revision of the state's commercial banking laws enacted at the instance of the banking industry, 1969 Tenn. Pub. Acts, ch. 36. Nothing in the statutes or their history indicates any legislative intent to abolish tenancy by the entirety in bank deposits held by spouses or to convert such accounts into some other form of ownership merely because they are payable to either or subject to individual checking or withdrawal. The statutes were designed to protect the paying bank, not to change a basic and fundamental form of property ownership in bank deposits.

The statutes do not distinguish between spouses and other types of joint depositors, but the substantive law of domestic relations has long done so.

Banking Law > ... > Bank Accounts > Deposit Accounts > General Overview

Contracts Law > Personal Property

HN8 See former *Tenn. Code Ann. § 45-2-703(a)* (1987).

Banking Law > ... > Bank Accounts > Deposit Accounts > General Overview

Banking Law > ... > Deposit Account Types > Joint Accounts > Tenancies by Entireties

Contracts Law > Personal Property

Governments > Legislation > Effect & Operation > Amendments

Real Property Law > Estates > Concurrent Ownership > Tenancies by Entireties

HN9 The Supreme Court of Tennessee , in examining the amendment to *Tenn. Code Ann. § 45-2-703(a)* (1987), has concluded that no substantive change has been made in *§ 45-2-703* relative to bank accounts created jointly by husband and wife and that Griffin v. Prince was not repudiated by the 1983 amendment. The amendment relieves the depository bank of responsibility to resist a third party's claim and the onus of establishing the status of the deposit, as one of tenancy by the entirety, has shifted from the bank to the other depositor.

Banking Law > ... > Bank Accounts > Deposit Accounts > General Overview

Banking Law > ... > Deposit Account Types > Joint Accounts > Tenancies by Entireties

Contracts Law > Personal Property

Evidence > Burdens of Proof > General Overview

Governments > Legislation > Effect & Operation > Amendments

Real Property Law > Estates > Concurrent Ownership > Tenancies by Entireties

HN10 The holding in Griffin v. Prince, the 1983 amendment to *Tenn. Code Ann. § 45-2-703*, and the interpretation of the amendment in the Edwards v. Edwards case clearly reflect that, prior to 1988, the law in Tennessee was that: (1) spouses held joint bank accounts as tenants by the entirety; (2) the 1983 amendment to *Tenn. Code Ann. § 45-2-703* was enacted to relieve banks of the responsibility for determining whether to release funds to a creditor; and (3) the amendment forced the non-debtor spouse, rather than the bank, to establish the status of the deposit, as one of tenancy by the entirety.

Banking Law > ... > Bank Accounts > Deposit Accounts > General Overview

Contracts Law > Personal Property

Governments > Legislation > Effect & Operation > Amendments

HN11 In 1988, the legislature again amended *Tenn. Code Ann. § 45-2-703(a)*, regarding jointly held bank accounts.

Banking Law > ... > Bank Accounts > Deposit Accounts > General Overview

Contracts Law > Personal Property

Governments > Legislation > Effect & Operation > Amendments

HN12 See *Tenn. Code Ann. § 45-2-703(a)*.

Banking Law > ... > Bank Accounts > Deposit Accounts > General Overview

Contracts Law > Personal Property

Governments > Legislation > Effect & Operation > Amendments

HN13 The amendment to *Tenn. Code Ann. § 45-2-703(a)* added five new subsections to the statute. *Tenn. Code Ann. § 45-2-703(c)-(g)*, 1988 Tenn. Pub. Acts 926, § 2. A review of the legislative history pertaining to this amendment reveals that the primary purpose behind the amendment was the addition of the new subsections, which "discussed multiple party accounts" and gave parties opening bank accounts the right to elect whether they wanted the account to carry with it a right of survivorship.

Banking Law > ... > Bank Accounts > Deposit Accounts > General Overview

Banking Law > ... > Deposit Account Types > Joint Accounts > Tenancies by Entireties

Contracts Law > Personal Property

Governments > Legislation > Effect & Operation > Amendments

Real Property Law > Estates > Concurrent Ownership > Tenancies by Entireties

Real Property Law > ... > Liens > Nonmortgage Liens > Judgment Liens

HN14 Even though the legislature, in amending *Tenn. Code Ann. § 45-2-703(a)*, added the language, "including, without limitation, any balance held by spouses," it seems clear that the legislature was not attempting to change the law of tenancy by the entirety; rather, it was simply clarifying,

probably for the primary benefit of banks, that all joint accounts were subject to the claims of creditors, including those held by spouses. A creditor had, and still has, the right to levy upon the funds in jointly-held bank accounts; it does not mean that the creditor ultimately will be entitled to keep the funds levied upon. The creditor's right to keep the funds will depend upon the proof adduced at the hearing in the subsequently-filed separate action by the non-debtor depositor.

Banking Law > ... > Bank Accounts > Deposit Accounts > General Overview

Civil Procedure > Judgments > Enforcement & Execution > Garnishment

Contracts Law > Personal Property

HN15 *Tenn. Code Ann. § 45-2-703(a)* provides a specific remedy for a non-debtor spouse depositor whose funds are garnished by the creditor of a debtor spouse. A non-debtor spouse depositor has a right under *§ 45-2-703(a)* to commence a separate action against the creditor to establish such rights as she may have in the funds.

Banking Law > ... > Bank Accounts > Deposit Accounts > General Overview

Contracts Law > Personal Property

HN16 The present version of *Tenn. Code Ann. § 45-2-703(a)* applies broadly to all bank deposits in the names of two or more persons, payable to either, or survivor and includes any balance held by spouses.

Banking Law > ... > Bank Accounts > Deposit Accounts > General Overview

Banking Law > ... > Deposit Account Types > Joint Accounts > Tenancies by Entireties

Contracts Law > Personal Property

Governments > Legislation > Effect & Operation > Amendments

Real Property Law > Estates > Concurrent Ownership > Tenancies by Entireties

Real Property Law > ... > Liens > Nonmortgage Liens > Judgment Liens

HN17 The Court of Appeals of Tennessee, at Knoxville , holds that the 1988 amendment to *Tenn. Code Ann. § 45-2-703(a)* expresses that deposits in the names of two or more persons, payable to either, or survivor means all such deposits, be they held by married individuals or otherwise. The court finds nothing in the language of the 1988 amendment to suggest that the legislature, by including the language "any balance held by spouses" intended to change the century-plus old law pertaining to the nature of the ownership interest of tenancy by the entirety. If this well-established form of ownership is to be changed, it should be done by the clearest of language. The current version of *Tenn. Code Ann. § 45-2-703(a)* does not evidence such a change. In so many words, the statute simply instructs banks to: (1) pay the funds into court; (2) get out of the way; and (3) let the non-debtor depositor "fight it out" with the creditor by showing such rights as that depositor may have in the funds. In the case of a non-debtor spouse depositor with respect to a joint account held by the parties as tenants by the entirety, those "rights" translate into an entitlement to the return of the levied-upon funds.

Banking Law > ... > Bank Accounts > Deposit Accounts > General Overview

Banking Law > ... > Deposit Account Types > Joint Accounts > Tenancies by Entireties

Contracts Law > Personal Property

Governments > Legislation > Effect & Operation > Amendments

Real Property Law > Estates > Concurrent Ownership > Tenancies by Entireties

Real Property Law > ... > Liens > Nonmortgage Liens > Judgment Liens

HN18 Under *Tenn. Code Ann. § 45-2-703(a)*, in the case of unmarried persons holding a joint account, the non-debtor account holder would be required to prove to the court that all, or part of, the levied-upon funds were directly attributable to him or her to the exclusion of the debtor depositor, in order for that portion of the funds to be returned to the non-debtor depositor. However, because married persons hold joint bank accounts as tenants by the entirety, each spouse is seized of the whole or the entirety and not of a share, moiety, or divisible part. Therefore, the non-debtor spouse need only prove to the court that the subject funds are in the parties' joint names and that he or she is married to the debtor spouse in order to entitle the plaintiff to the return of all levied-upon funds. When the legislature used the language, "may, by commencing a separate action against the creditor, establish such rights as that depositor may have in the funds," it mandated what the non-debtor depositor needed to do; it did not purport to change the nature of the rights of a married non-debtor depositor.

Contracts Law > Personal Property

Real Property Law > Estates > Concurrent Ownership > Tenancies by Entireties

HN19 There is absolutely nothing in the common law, statutory law, or legislative history in Tennessee evincing an intent to change the law with respect to tenancy by the entirety.

Counsel: Harold B. Stone and Mark E. Brown, Knoxville, Tennessee, for the appellants, Christa A. Avenell and James S. Avenell.

Lance A. Evans, Maryville, Tennessee, for the appellee, James Allen Gibson.

Judges: CHARLES D. SUSANO, JR., J., delivered the opinion of the court, in which SHARON G. LEE, J., joined. HERSCHEL P. FRANKS, P.J., filed a separate dissenting opinion.

Opinion by: CHARLES D. SUSANO, JR.

Opinion

Christa A. Avenell, [1] sometimes referred to herein as "the plaintiff," brought this action against James Allen Gibson ("the creditor"), seeking to recover funds taken out of the Avenells' two joint accounts by their bank in response to a levy of execution. The trial court held that the 1988 amendment to *Tenn. Code Ann. § 45-2-703* (2000) changed the law with respect to bank accounts held by individuals as tenants by the entirety; that Mrs. Avenell failed to prove she was entitled to the levied-upon funds; and [*2] that the creditor was entitled to retain the funds paid into court by the Avenells' bank. The plaintiff and her husband appeal. We reverse.

I.

The plaintiff, whose name was then Christa A. Montano, [2] opened a checking account and a savings account at First Tennessee Bank ("the Bank") on December 1, 1997. On September 11, 1998, she married James S. Avenell. The following month, Mr. Avenell was added to the plaintiff's checking account. On the account [*3] signature card, a box was checked to reflect that the Avenells held the account as "joint tenants with right of survivorship." On April 30, 1999, Mr. Avenell was also added to his wife's savings account; the signature card on the latter account was also checked to show that the account was held by the Avenells as "joint tenants with right of survivorship."

On August 15, 2001, the creditor advanced Mr. Avenell $ 30,000. The plaintif was not a party to this transaction and did not sign the note to the creditor. Sixteen months later, the creditor obtained a judgment in the amount of $ 13,000 against Mr. Avenell on the note signed by him. On January 15, 2003, the creditor levied upon the Avenells' joint checking and savings accounts. As a result of the levy, the Bank paid into court $ 1,000 from the checking account and $ 10,201 from [*4] the savings account.

On March 14, 2003, the plaintiff filed a complaint in the trial court against the creditor, seeking to recover the funds the creditor had obtained through his levy of execution. In her complaint, the plaintiff asserted that the funds were taken from bank accounts that were held by the Avenells as tenants by the entirety. Her complaint was filed pursuant to *Tenn. Code Ann. § 45-2-703(a)*, and sought the return of the funds that had been paid into court.

A bench trial was held on May 4, 2004. Relying upon an unpublished opinion of this court, the trial court determined that the law with respect to bank accounts held by parties as tenants by the entirety was changed by the 1988 amendment to *Tenn. Code Ann. § 45-2-703(a)*; that the plaintiff had failed to prove her separate entitlement to the funds levied upon; and that the creditor was entitled to retain the fruits of his levy. From this judgment, Mrs. Avenell and her husband appeal.

II.

HN1 In this non-jury case, our review is *de novo* upon the record of the proceedings below; but the record comes to us with a presumption of correctness as to the trial [*5] court's factual findings that we must honor "unless the preponderance of the evidence is otherwise." *Tenn. R. App. P. 13(d)*. The trial court's conclusions of law, however, are accorded no such presumption. ***Campbell v. Florida Steel Corp., 919 S.W.2d 26, 35 (Tenn. 1996)***; ***Presley v. Bennett,***

[1] The "Memorandum and Order" of the trial court entered June 18, 2004, recites that "although Mr. Avenell was not originally named a party to this action, at the court's suggestion, and with his presence and consent, he was added as a party plaintiff." It appears the trial court believed that Mr. Avenell should be a party, probably because he was the judgment debtor and one of the parties whose names appeared on the joint bank accounts. For ease of reference, we will refer to the plaintiff in the singular and, in doing so, we are referring to Mrs. Avenell.

[2] When these accounts were originally opened, the plaintiff was married to a Mr. Montano. On January 5, 1999, following her marriage to Mr. Avenell, she changed her surname to Avenell.

860 S.W.2d 857, 859 (Tenn. 1993).

III.

The primary, and dispositive, issue raised on this appeal is whether Tenn. Code Ann. § 45-2-703(a), as amended in 1988, changed the long-standing law in Tennessee with respect to bank accounts held by married parties as tenants by the entirety. This issue presents a question of law. **Eastman Chem. Co. v. Johnson**, 151 S.W.3d 503, 506 (Tenn. 2004). Accordingly, we accord no presumption of correctness to the trial court's judgment. ***Id.***

"Our ***HN2*** duty in construing statutes is to ascertain and give effect to the intention and purpose of the legislature." ***Id.*** at 507.

IV.

HN3 "Tenancy by the entirety is, of course, a form of property ownership unique to married persons," and the ability of married persons to hold property as [*6] tenants by the entirety is well-established in this state. **Griffin v. Prince**, 632 S.W.2d 532, 534-35 (Tenn. 1982). When the statute emancipating married women was enacted in 1913, *see* Tenn. Code Ann. § 36-3-504 (2001), the Supreme Court initially held that the statute had abolished the concept of tenancy by the entirety. *See* **Kellar v. Kellar**, 142 Tenn. 524, 221 S.W. 189, 190 (Tenn. 1920); **Gill v. McKinney**, 140 Tenn. 549, 205 S.W. 416, 418 (Tenn. 1918). However, in 1919, the legislature enacted legislation, now codified at Tenn. Code Ann. § 36-3-505 (2001), which expressly states that "nothing in [the emancipation statute] shall be construed as abolishing tenancies by the entirety." *See* **Bost v. Johnson**, 175 Tenn. 232, 133 S.W.2d 491, 492 (Tenn. 1939). Thus, with the exception of the six-year period from 1913 to 1919, tenancy by the entirety has been a recognized form of property ownership in this state for over a century.

HN4 When married individuals hold property as tenants by the entirety, "each spouse is seized of the whole [*7] or the entirety and not of a share, moiety, or divisible part." **Sloan v. Jones**, 192 Tenn. 400, 241 S.W.2d 506, 507 (Tenn. 1951). The rule in this state has long been that personal property, as well as realty, may be held by spouses by the entirety. *See* **Campbell v. Campbell**, 167 Tenn. 77, 66 S.W.2d 990, 992 (Tenn. 1934). As particularly relevant to the facts of the instant case, the Supreme Court has expressly held that ownership by the entirety may extend to bank accounts. *See* **Sloan**, 241 S.W.2d at 509.

In 1982, the Supreme Court was faced with a case similar to the one at bar, in which a creditor of a husband attempted to levy upon funds in the parties' joint checking and savings accounts. **Griffin**, 632 S.W.2d at 533. The signature cards associated with the two accounts reflected that the accounts were held in the name of the husband *or* the wife, and both cards stated that the accounts were joint accounts with right of survivorship. ***Id.*** at 533, 534. The creditor took the position that the use of the word "or" between the parties' names rather than "and," in addition [*8] to the designation of the accounts as joint accounts with right of survivorship, created a *joint tenancy* rather than a tenancy by the entirety. ***Id.*** at 534, 535. The Supreme Court, however, was quick to state that the law is well-established "that ***HN5*** the words of a conveyance or legal instrument which would make two other persons joint tenants under the common law, or tenants in common under [what is now Tenn. Code Ann. § 66-1-107], will create tenancy by the entirety in a husband and wife." ***Id.*** at 535. Further, the court noted the abundance of authority in Tennessee holding "that the use of the word 'or' between the names of spouses on a bank account or negotiable instrument does not preclude their ownership of the asset by the entirety." ***Id.*** at 536.

The creditor in the **Griffin** case also argued that the fact one spouse could write a check or make a withdrawal on the accounts without requiring the signature of the other spouse supported a finding that the accounts were not held by the parties as tenants by the entirety. ***Id.*** at 537. In response to this [*9] argument, the court quoted the language of Tenn. Code Ann. § 45-2-703(a), which, at that time, provided as follows:

> ***HN6*** When a deposit has been made or shall hereafter be made, in any bank in the names of two (2) or more persons, payable to either, or survivor, such deposit, or any part thereof, or any interest or dividend thereon, may be paid to either of said persons, whether the others be living or not; and the receipt or acquittance of such person so paid shall be a valid and sufficient release and discharge to the bank for any payment so made.

Tenn. Code Ann. § 45-2-703(a) (1980). The court placed the following interpretation on the language of the statute:

> This statute ***HN7*** was part of a major revision of the state's commercial banking laws enacted at the instance of the banking industry, 1969 Tenn. Pub. Acts, ch. 36. Nothing in the statutes or their history indicates any legislative intent to abolish tenancy by the entirety in bank deposits held by spouses or to convert such accounts into some other form of ownership merely because they are payable to either or subject to individual checking or [*10]

> withdrawal. The statutes just quoted were designed to protect the paying bank, not to change a basic and fundamental form of property ownership in bank deposits. The statutes do not distinguish between spouses and other types of joint depositors, but the substantive law of domestic relations has long done so.

Id. (internal footnote omitted). The court in ***Griffin*** determined that the accounts of the husband and wife were held by them as tenants by the entirety and ordered that the funds levied upon in the lower court be released to them. ***Id. at 538***.

Following the release of the ***Griffin*** opinion, the legislature, in 1983, amended *Tenn. Code Ann. § 45-2-703(a)* by adding the following sentence:

> ***HN8*** Any balance so created shall be subject to assignment by, or the claim of any creditor of, either depositor, as if such depositor were the sole owner of the funds; provided, however, that if such creditor realizes its claim, by garnishment, set off, or otherwise, any other depositor may, by appropriate action against the creditor, establish such rights as that depositor may have in the funds.

[*11] *Tenn. Code Ann. § 45-2-703(a)* (Supp. 1987).

In ***Edwards v. Edwards***, ***HN9*** the Supreme Court, in examining this amendment, concluded that "no substantive change has been made in [*Tenn. Code Ann.] § 45-2-703* relative to bank accounts created jointly by husband and wife" and that ***Griffin*** "was not repudiated by the 1983 amendment." ***Edwards v. Edwards, 713 S.W.2d 642, 646 (Tenn. 1986)***. The court went on to state that "the amendment relieves the depository bank of responsibility to resist a third party's claim" and that the onus "of establishing the status of the deposit, as one of tenancy by the entirety, has shifted from the bank to the 'other' depositor." ***Id.***

HN10 The holding in ***Griffin***, the 1983 amendment to *Tenn. Code Ann. § 45-2-703*, and the interpretation of the amendment in the ***Edwards*** case clearly reflect that, prior to 1988, the law in this state was that (1) spouses held joint bank accounts as tenants by the entirety; (2) the 1983 amendment to *Tenn. Code Ann. § 45-2-703* was enacted to relieve [*12] banks of the responsibility for determining whether to release funds to a creditor; and (3) the amendment forced the non-debtor spouse, rather than the bank, to establish "the status of the deposit, as one of tenancy by the entirety." ***Edwards, 713 S.W.2d at 646***.

HN11 In 1988, the legislature again amended *§ 45-2-703(a)*, replacing the second sentence added in 1983 with the following language:

> ***HN12*** Any balance so created, *including*, without limitation, *any balance held by spouses*, shall be subject to assignment by, or the claim of any creditor of, either depositor, as if such depositor were the sole owner of the funds; provided, that if such creditor realizes its claim by any means other than enforcement of an assignment, pledge, or the grant of a security interest made by any one (1) of such depositors, any other depositor not indebted to the creditor may, by commencing a separate action against the creditor, establish such rights as that depositor may have in the funds.

Tenn. Code Ann. § 45-2-703(a) (emphasis added).

The amendment also ***HN13*** added five new subsections to the statute. *See Tenn. Code Ann. § 45-2-703(c)* [*13] *-(g)*; 1988 Tenn. Pub. Acts 926, § 2. A review of the legislative history pertaining to this amendment reveals that the primary purpose behind the amendment was the addition of the new subsections, which "discussed multiple party accounts" and gave parties opening bank accounts the right to elect whether they wanted the account to carry with it a right of survivorship. *See* Tenn. Gen. Assemb., 95th G.A., 2d Sess. (1988), House Comm. on Commerce (April 5, 1988, tape # 2) (statements of William A. Byrn, Jr., Member, Tenn. Bar. Assoc. Prob. Study Comm.).

We believe the legislative history reflects that the legislature did not intend to make a "substantive change" in the law with respect to tenancy by the entirety. *See* Tenn. Gen. Assemb., 95th G.A., 2d Sess. (1988), Senate (February 17, 1988, tape # S-21) (statements of Lt. Gov. John S. Wilder). In fact, our careful review of the legislative history indicates only one instance in which the amendment to subsection (a) of the statute is referenced. Attorney William A. Byrn, Jr., who was testifying before the House Commerce Committee on behalf of the Tennessee Bar Association, responded to a question posed by Representative West as [*14] follows:

> West: Mr. Byrn, is it true that under this bill, an account in the names of two (2) or more persons, regardless of their relationships, would be subject to the claims of creditors of either of the two (2) or more depositors?
>
> Byrn: That is right and that is the present law, Mr. West.

Tenn. Gen. Assemb., 95th G.A., 2d Sess. (1988), House Comm. on Commerce (April 5, 1988, tape # 2). Mr. Byrn then made the following comment:

> The only thing changed [in subsection (a)] is by adding the words in that . . . [″]by commencing a separate action.[″] It's hazy procedurally under the present law that sometimes a person may be charged for reimbursement without actually being a party to the suit, so this is not [a] change in the present law in subparagraph a.

Id.

Thus, ***HN14*** even though the legislature, in amending subsection (a) of the statute, added the language, ″including, without limitation, any balance held by spouses,″ it seems clear to us that the legislature was not attempting to change the law of tenancy by the entirety; rather, it was simply clarifying - probably for the primary benefit of banks - that all joint accounts were subject [*15] to the claims of creditors, including those held by spouses. Moreover, the query posed by Mr. West regarding joint accounts being subject to the claims of creditors of either of the two depositors, and Mr. Byrn's response that that was the current state of the law, merely emphasizes that a creditor had, and still has, the right to *levy* upon the funds in jointly-held bank accounts; it does not mean that the creditor ultimately will be entitled to *keep* the funds levied upon. The creditor's right to *keep* the funds will depend upon the proof adduced at the hearing in the subsequently-filed separate action by the non-debtor depositor.

In the instant case, the creditor contends that the 1988 amendment to the statute changed the law of tenancy by the entirety in that, according to the creditor, a non-debtor spouse must now prove personal entitlement to the levied-upon funds just as a non-debtor depositor would with respect to an account in joint tenancy where the depositors are not married. In support of his position, the creditor relies upon an unpublished opinion of this court, ***Al-Haddad Brothers v. Intersparex Ledden KG***, *1993 Tenn. App. LEXIS 10, No. 01A01-9207-CH-00298, 1993 WL 4858* [*16] (Tenn. Ct. App. M.S., filed January 13, 1993). In ***Al-Haddad***, the creditor garnished funds from a bank account held jointly by a debtor male and a female who ostensibly were married to each other. *1993 Tenn. App. LEXIS 10, [WL] at *1*. The depositors then moved the trial court to set aside the garnishment on the ground that the bank account was held by them as tenants by the entirety and that they were therefore entitled to the return of the funds. ***Id.***

Following a detailed examination of the woman's claim of entitlement to certain deposits in the accounts, the court found that she failed to prove that the funds were her property. *1993 Tenn. App. LEXIS 10, [WL] at *3-*4*. With respect to the woman's claim that the account was held with her spouse as tenants by the entirety, the court pointed out that the wife's reliance on the ***Griffin*** case was misplaced, as that decision was rendered before the statute was amended in 1988 to include the language ″including, without limitation, any balance held by spouses.″ ***Al-Haddad***, *1993 Tenn. App. LEXIS 10, 1993 WL 4858, at *3*. However, the court went on to state that the parties were not validly married because their purported marriage occurred before the [*17] man's divorce from his first wife was finalized. *1993 Tenn. App. LEXIS 10, [WL] at *4*. Because of the voidness of their purported marriage, the court ruled that they did not hold the subject account as tenants by the entirety. ***Id.***

Because the ***Al-Haddad*** case did not involve a bank account held in the names of tenants by the entirety, the reasoning employed by the court with respect to the meaning and interpretation of *Tenn. Code Ann. § 45-2-703*, as that statute pertains to accounts held jointly by married individuals, is clearly dicta. ***Al-Haddad*** has no precedential value in this case, involving, as it does, a joint account owned by persons in a valid subsisting marriage.

In addition to ***Al-Haddad***, the creditor relies upon another unpublished opinion of this court to support his argument. ***See Harber v. Nolan***, *2000 Tenn. App. LEXIS 512, No. E2000-00356-COA-R3-CV, 2000 WL 1100229 (Tenn. Ct. App. E.S., filed August 3, 2000)*. In ***Harber***, we made the following statement:

> ***HN15*** [*Tenn. Code Ann.] § 45-2-703(a)* provides a specific remedy for a non-debtor spouse depositor whose funds are garnished by the [*18] creditor of a debtor spouse. Ms. Harber, as a non-debtor spouse depositor, has a right under [*Tenn. Code Ann.] § 45-2-703(a)* to ″commence a separate action against the creditor″ to establish such rights as she may have in the funds.

*2000 Tenn. App. LEXIS 512, [WL] at *3*. In the case at bar, the creditor contends that ***Harber*** supports his position that the non-debtor spouse must prove that all, or part of, the funds in the bank account are *directly attributable to him or her.* We disagree. The above-quoted language merely states that a non-debtor spouse, under the statute, may bring a

separate action against the creditor to "establish such rights as [he or] she may have in the funds." This is nothing more than a self-evident truism. It says absolutely nothing about the nature and extent of the "rights" of the non-debtor spouse depositor.

HN16 The present-version of the statute applies broadly to all deposits "in the names of two (2) or more persons, payable to either, or survivor" and includes "any balance held by spouses." As relevant to the facts of the instant case, the meaning of the statute is clear: when a bank receives a garnishment or execution [*19] arising out of a "claim of any creditor of [] either depositor," the bank must respond "as if such depositor were the sole owner of the funds." That is precisely what the bank did in the instant case. It paid monies from the two accounts into court as if Mr. Avenell were the "sole owner of the funds."

We ***HN17*** hold that the 1988 amendment expresses that which was clearly set forth in ***Edwards***, *i.e.*, that deposits "in the names of two (2) or more persons, payable to either, or survivor" means *all* such deposits - be they held by married individuals or otherwise. It is reasonable to assume that the banking industry sought the amendment lest there be any doubt, in view of the Supreme Court's decision in ***Edwards***, as to the scope of the relief of responsibility vested upon them by the statute. We find nothing in the language of the 1988 amendment to suggest that the legislature, by including the language "any balance held by spouses" intended to change the century-plus old law pertaining to the nature of the ownership interest of tenancy by the entirety. If this well-established form of ownership is to be changed, it should be done by the clearest of language. The [*20] current version of *Tenn. Code Ann. § 45-2-703(a)* does not evidence such a change. In so many words, the statute simply instructs banks to (1) pay the funds into court, (2) get out of the way, and (3) let the non-debtor depositor "fight it out" with the creditor by showing "such rights as that depositor may have in the funds." In the case of a non-debtor spouse depositor with respect to a joint account held by the parties as tenants by the entirety, those "rights" translate into an entitlement to the return of the levied-upon funds.

HN18 In the case of unmarried persons holding a joint account, the non-debtor account holder *would* be required to prove to the court that all, or part of, the levied-upon funds were directly attributable to him or her to the exclusion of the debtor depositor, in order for that portion of the funds to be returned to the non-debtor depositor. However, because married persons hold joint bank accounts as tenants by the entirety, "each spouse is seized of the whole or the entirety and not of a share, moiety, or divisible part." ***Sloan, 241 S.W.2d at 507***. Therefore, the non-debtor spouse need only prove to the [*21] court that the subject funds are in the parties' joint names and that he or she is married to the debtor spouse in order to entitle the plaintiff to the return of *all* levied-upon funds. When the legislature used the language, "may, by commencing a separate action against the creditor, establish such rights as that depositor may have in the funds," it mandated what the non-debtor depositor needed to do; it did not purport to change the nature of the rights of a married non-debtor depositor.

We hold that ***HN19*** there is absolutely nothing in the common law, statutory law, or legislative history in this state evincing an intent to change the law with respect to tenancy by the entirety. ***Griffin*** and ***Edwards*** control the issue before us. Because the plaintiff in the instant case proved (1) that the funds garnished by the creditor were taken from an account held by the parties as tenants by the entirety and (2) that she and Mr. Avenell are married, she is entitled to a dismissal of the levy of execution and a release of the funds.

V.

In addition to the primary issue, the plaintiff asserts that the trial court erred in weighing the equities of the case and in concluding [*22] that the equities weighed in favor of a finding for the creditor. This issue is rendered moot in light of our decision with respect to the law of tenancy by the entirety and our resulting reversal of the trial court's ruling.

VI.

The creditor requests that we award him attorney fees, costs, and expenses incurred in defending this appeal, on the basis that the appeal is a frivolous one. In view of our decision in favor of the appealing party, this successful appeal can hardly be characterized as frivolous.

VII.

The judgment of the trial court is reversed. This case is remanded to the trial court "with directions to dismiss the [levy of execution] and to release the funds to the order of [the Avenells]." ***Griffin, 632 S.W.2d at 538***. Costs on appeal are taxed to the appellee, James Allen Gibson.

CHARLES D. SUSANO, JR., JUDGE

Dissent by: HERSCHEL PICKENS FRANKS

Dissent

DISSENTING OPINION

I agree with the majority opinion's analysis until it undertakes consideration of the 1988 amendment to *Tenn. Code Ann. § 45-2-703(a)*. As quoted in the majority opinion, the amendment states:

> Any balance so created, [*23] *including*, without limitation, *any balance held by spouses*, shall be subject to assignment by, or the claim of any creditor of, either depositor, as if such depositor were the sole owner of the funds; provided that is such creditor realizes its claim by any means other than enforcement of an assignment, pledge, or the grant of a security interest made by any one (1) of such depositors, any other depositor not indebted to the creditor may, by commencing a separate action against the creditor, establish such rights as that depositor may have in the funds.

The majority argues this amendment was merely a clarification, i.e., "that all accounts were subject to the claims of creditors, including those held by spouses", and was solely for the benefit of banks.

In my view, the quoted language is not ambiguous and under the familiar rules, we are required to give every word in the statute its ordinary and accepted meaning, and give effect to it. Clearly, the provision literally applies to "any balance held by spouses", which includes any balances created under the rubric of tenants by the entireties. Likewise, the remaining provision authorizing the "other depositor" to establish [*24] his or her rights to the funds applies to any balance "including . . . any balance held by spouses."

I would hold as the Chancellor did, that the legislature intended that a debtor can no longer place his assets beyond reach of his creditors by simply creating a tenants by the entireties account and placing his assets in such an account. This legislation protects the innocent spouse if the fund in fact was placed in the account by the spouse who owes a creditor nothing.

The majority argues that had the legislature intended to include such accounts in the entire scope of the statute, that it would have done so with the "clearest of language". I disagree. Had the legislature intended to exempt tenants by the entireties accounts from the scope of these provisions, it would have so expressed and would not have burdened spouses with having to file a claim in court to protect these accounts.

I would affirm the Judgment of the Trial Court.

HERSCHEL PICKENS FRANKS, P.J.

State v. Strode

Court of Criminal Appeals of Tennessee, at Nashville

January 24, 2006, Session ; June 8, 2006, Filed

No. M2005-00906-CCA-R9-DD

Reporter
2006 Tenn. Crim. App. LEXIS 454; 2006 WL 1626919

STATE OF TENNESSEE v. DANNY STRODE

Subsequent History: Appeal granted by State v. Strode, 2006 Tenn. LEXIS 858 (Tenn., Sept. 25, 2006)
Affirmed by, Remanded by State v. Strode, 2007 Tenn. LEXIS 666 (Tenn., Aug. 14, 2007)

Prior History: [*1] Tenn. R. App. P. 9 Appeal as of Right; Judgment of the Trial Court is Reversed. Appeal from the Circuit Court for Marion County. No. 7310. J. Curtis Smith, Judge.

Disposition: Judgment of the Trial Court is Reversed.

Core Terms

mentally retarded, score, trial court, tests, manifested, deficits, prong, adaptive behavior, adaptive, records, skills, functioning, requires, death penalty, intelligence, statutes, eighteen years, diagnosis, Subtest, preponderance of the evidence, malingering, evaluated, birthday, purposes, retarded, argues, mild, years old, subaverage, Manual

Case Summary

Procedural Posture

Defendant was indicted in the Circuit Court for Marion County (Tennessee) for one count of premeditated murder, one count of felony murder, and one count of especially aggravated robbery. The State sought the death penalty. However, the trial court determined that defendant was mentally retarded. The State appealed.

Overview

The State argued that the trial court erred in finding that defendant was ineligible for the death penalty because he was considered to be mentally retarded under the definition provided in Tenn. Code Ann. § 39-13-203(a). The court of appeals agreed. Section 39-13-203(a) required that the symptoms manifested themselves before the age of eighteen. At the age of eight defendant scored an 88 on an I.Q. test. In 1992 at the age eleven he scored 75. In 1995 and in 1996 at the ages of thirteen and fifteen he scored 78 both times. There were no I.Q. scores for defendant before the age of eighteen which were below 70. An expert concluded that it was unlikely that defendant had deficits in adaptive behavior. The expert relied on the fact that defendant was able to hold several jobs, such as backhoe operator, a dairy farmer, a factory worker, a fast food worker and a baby-sitter. In addition, defendant had obtained his driver's license, saved money to purchase a car, and established some type of living situation. Therefore, the evidence preponderated against the findings of the trial court.

Outcome

The judgment was reversed.

LexisNexis® Headnotes

Criminal Law & Procedure > Sentencing > Capital Punishment > General Overview

Criminal Law & Procedure > Sentencing > Mental Incapacity

HN1 For a defendant to be found mentally retarded and therefore ineligible for the death penalty, he must meet the definition for mental retardation as provided in Tenn. Code Ann. § 39-13-203.

Criminal Law & Procedure > Sentencing > Mental Incapacity

HN2 See Tenn. Code Ann. § 39-13-203(a).

Criminal Law & Procedure > Trials > Burdens of Proof > Defense

Criminal Law & Procedure > Sentencing > Cruel & Unusual Punishment

Criminal Law & Procedure > Sentencing > Mental Incapacity

Criminal Law & Procedure > ... > Standards of Review > De Novo Review > General Overview

Criminal Law & Procedure > ... > Standards of Review > Deferential Review > General Overview

HN3 The execution of mentally retarded defendants constitutes cruel and unusual punishment under the constitutions of both the United States and the State of Tennessee. The burden of persuasion to demonstrate that he is mentally retarded is on the defendant, and the trial court must determine by the preponderance of the evidence whether a defendant is indeed mentally retarded. *Tenn. Code Ann. § 39-13-203(c)*. The question of whether an individual is mentally retarded for purposes of application of the death penalty is a mixed question of law and fact. Therefore, the trial court's findings must be reviewed with a presumption of correctness and only reversed when the preponderance of the evidence is contrary to the findings of the trial court. When reviewing the application of the law to the facts, the appellate court must conduct a purely de novo review.

Criminal Law & Procedure > Sentencing > Cruel & Unusual Punishment

Criminal Law & Procedure > Sentencing > Mental Incapacity

HN4 The Eighth Amendment prohibits "cruel and unusual punishment" and precludes the death penalty for persons adjudicated mentally retarded.

Criminal Law & Procedure > ... > Standards of Review > De Novo Review > General Overview

Governments > Legislation > Interpretation

HN5 A question of interpretation of a statute is purely a question of law and is subject to a de novo review.

Criminal Law & Procedure > Appeals > Standards of Review > General Overview

Governments > Legislation > Interpretation

HN6 Generally, when construing a statute, every word within the statute is presumed to have meaning and purpose and should be given full effect. An appellate court's primary duty in construing a statute is to ascertain and give effect to the legislative intent without unduly restricting or expanding a statute's coverage beyond its intended scope. Legislative intent should be gleaned from the natural and ordinary meaning of the language used, without a forced or subtle construction that would limit or extend the meaning of the language. Furthermore, the appellate court should construe a statute so that its component parts are consistent and reasonable, and inconsistent parts should be harmonized, where possible.

Criminal Law & Procedure > Sentencing > Capital Punishment > General Overview

Criminal Law & Procedure > Sentencing > Mental Incapacity

HN7 For a defendant to meet the third prong of *Tenn. Code Ann. § 39-13-203(a)*, the symptoms of mental retardation must have manifested by the age of eighteen.

Counsel: Paul G. Summers, Attorney General & Reporter; Michelle Chapman McIntire, Assistant Attorney General; J. Michael Taylor, District Attorney General, and James W. Pope, III, Assistant District Attorney General, for the appellant, State of Tennessee.

Cynthia A. LeCroy-Schemel, Chattanooga, Tennessee, for the appellee, Danny Strode.

Judges: JERRY L. SMITH, J., delivered the opinion of the court, in which THOMAS T. WOODALL and ROBERT W. WEDEMEYER, JJ., joined.

Opinion by: JERRY L. SMITH

Opinion

The defendant, Danny Strode, was indicted by the Bledsoe County Grand Jury for one count of premeditated murder, one count of felony murder and one count of especially aggravated robbery. The State sought the death penalty. The defendant asserted he could not be put to death because he was mentally retarded within the meaning of *Tennessee Code Annotated section 39-13-203(a)*. The trial court held a hearing and determined that the defendant was indeed mentally retarded under [*2] the definition provided in the statute and therefore could not be sentenced to death. The State requested permission to pursue an interlocutory appeal which was granted by the trial court. On appeal, we determine that the defendant is not mentally retarded under the definition of the statute and, therefore, reverse the judgment of the trial court.

OPINION

Factual Background

On March 25, 2002, the Bledsoe County Grand Jury indicted the defendant for the beating death of Harvey Brown, a local store owner. His charged offenses included one count of first degree premeditated murder, one count of felony murder and one count of especially aggravated robbery. The State filed a notice it would seek the death

penalty. On September 21, 2004, the defendant filed a motion to strike the death penalty asserting that he was mentally retarded. In October of 2004, the State requested that the defendant undergo a mental evaluation. An agreed order was entered January 5, 2005 requiring the defendant to be evaluated. On March 2, 2005 the trial court held a hearing on the issue of whether the defendant was mentally retarded.

Evidence at Hearing

Margie Strode Crawford testified [*3] at the hearing. Sometime after March, 1993 she took in the defendant as a foster child. [1] The defendant was twelve years old at the time. Ms. Crawford adopted the defendant sometime thereafter, and he took the last name Strode. She testified that the defendant never made friends very easily, and he did not fit in well with society. He had problems with "basic matters of hygiene." She stated that she had to keep after him to brush his teeth, take a bath and dress in presentable clothes. She believed that he did not understand why he needed to stay clean and brush his teeth. Ms. Crawford also did not believe that the defendant had the proper background to "catch on" to things he needed to do around the house. The defendant also did not do well in school. Ms. Crawford did not believe that the defendant could ever live independently. Ms. Crawford met with Dr. Robert W. Brown, Jr. and filled out a survey discussing the defendant. On cross-examination, Ms. Crawford testified that she was keeping four to six foster children at the same time she kept the defendant. She also stated that the defendant only stayed with her about two years and left when he was thirteen or fourteen. After he left, [*4] she only saw him one time at a "house that was for disturbed children" and not again until he was arrested for the incident in question.

Dr. Brown testified at the hearing on behalf of the defendant. He saw the defendant four different times on four different days in 2004. These visits included clinical observations, interviews, review of records with the defendant, and psychological testing. Dr. Brown estimated that he spent a total of twenty hours with the defendant. Dr. Brown asked the defendant about several incidents that were reported in documents supplied to Dr. Brown. The defendant was unable to give much additional information and claimed that he could not remember many of the incidents about which Dr. Brown asked him. Dr. Brown also interviewed Margie Strode Crawford, the defendant's foster and later adoptive mother. Prior to testing the defendant's I.Q., Dr. Brown tested the defendant to ensure that [*5] he was not malingering. Following the administration of nine tests, Dr. Brown concluded that the defendant was not malingering or attempting to fake a psychiatric disturbance. The defendant's scores were low on these tests. As a result of the low scores, Dr Brown tested the defendant's verbal learning memory and discovered that the defendant had significant problems in this area. Dr. Brown also did testing to determine the defendant's I.Q. Dr. Brown testified that he administered the Wechsler Adult Intelligence Scale, the Third Edition ("WAIS-III"). Dr. Brown stated the following regarding the Matrix Reasoning Subtest, which is included in the WAIS-III:

> Q. All right. One of the, I guess, subtest, if you will, or parts of the instruments was the Matrix Reasoning -
>
> A. (Interposing) Yes, ma'am.
>
> Q. Subtest. Can you tell us what that is and what showed, what you did from there?
>
> A. The instrument is looking at some designs and you're relying primarily on visual spacial functions, right hemispheric functions to recognize and pick from these designs. It's a new test and I really like it. It has excellent research behind it, but we've run into problems with it and I've found that over [*6] time particularly when there's a question of brain damage, traumatic brain injury, strokes, severe dementia, that I can't rely on it and other neuropsychologist [sic] have found the same thing. Our opinion is and that's to be debated yet with peer review and additional research is that it maybe [sic] the publisher was a little premature in issuing this subtest. What they did is they replaced a test that had been used in all previous versions called the Object Assembly Test with the Matrix Reasoning Test and there's good rational [sic] for that. Fortunately they retained it as a optional test to give the Object Assembly Test if for any reason there's problems with the Matrix Reasoning Test.
>
> Q. And I believe you actually encountered problems with the Matrix Reasoning Test, is that correct, as it was presented to Danny?
>
> A. Well, it was a high score and I have seen this routinely in cases of this type.
>
> Q. So when you say high score what do you mean?
>
> A. Well, it was relatively higher than the rest of the scores and I don't trust it, even if it were a lower

[1] Ms. Crawford remarried and became Margie Strode Crawford sometime after the defendant left her care.

score I have doubts in the instrument the way it's currently designed it needs some revision.

Q. All right. So what did you [*7] then do because of this score?

A. I replaced that which is standard procedure in the manual with a Subtest called the Object Assembly Test -

Q. (Interposing) And that's the old test?

A. That's the old test.

Q. Or the previous test that had been used.

A. But it's still included with the WAIS-III battery.

Q. Very well. And what was your conclusion or your findings in replacing that?

A. That his score overall dropped just slightly on the Full Scale IQ which is the critical question in a case such as this and it resulted in Full Scale IQ score calculated as 69. The critical issue here is that mild mental retardation is diagnosed with IQ scores ranging from 50 to 55 up to 70 and here is a score a Full Scale IQ of 69. However that score must be taken in consideration all the other scores on the tests, because we have a range that go from mild MR., mild retardation on up into low average performance and we have a range of scores, so the IQ, the Full Scale IQ Test does not tell the whole story and you'd have to do further analysis to - because it's quite possible that an individual can have some scores that are up in superior range, you know, but on so many other scales so low that [*8] they would perform very low on a Full Scale IQ, so you can't always go by - and some time I literally throw out the Full Scale IQ., because it doesn't provide me manful [sic] information.

Dr. Brown also testified that he reviewed results of previous I.Q. tests that the defendant had taken. The results for the previous tests showed that the defendant had a Full Scale IQ of 88 in 1990 when he was nine years old, 75 in 1992 when he was eleven years old, 78 in 1995 when he was fourteen years old and 78 in 1996 when he was fifteen years old. Dr. Brown stated that a decrease in I.Q. score as one ages is to be expected in an individual with a learning disorder.

Dr. Brown stated that to determine whether an individual is classified as mentally retarded, you must assess his adaptive function as well as academic achievement. In his review of the defendant's documentation, Dr. Brown did not find any records from his school age years where anyone had formally evaluated his adaptive function. Because there had been no formal evaluation, Dr. Brown spoke with Margie Strode Crawford, who was the defendant's foster mother and later adoptive mother, to ascertain the defendant's adaptive behavior [*9] when he was in his school years. From that interview, Dr Brown determined that the defendant suffered from some serious cognitive defects, but did not have a history of any traumatic brain injury or neurological disease that would impact his neurological functioning. Ms. Crawford told Dr. Brown that she did not believe that the defendant could ever live independently. Dr. Brown also relied upon a report from Youth Villages, where the defendant lived after leaving Ms. Crawford's home in which Youth Villages did an appraisal at age nineteen and determined that the defendant "lacked independent living skills necessary for successful living following discharge."

Dr. Brown determined that the defendant met the first two prongs for the definition for mental retardation in *Tennessee Code Annotated section 39-13-203(a)*. However, he stated that there was a problem with the third prong which requires that the diagnosis occur before the age of eighteen. However, Dr. Brown was convinced that the defendant's problems were present when he was in kindergarten as well as the present time. Therefore, Dr. Brown opined that the third prong had been met.

On cross-examination, [*10] Dr. Brown stated that the defendant was adapting to the jailhouse environment pretty well. The defendant had no complaints. Dr. Brown admitted that if he had left the Matrix score in his calculation of the defendant's Full Scale I.Q., the defendant's score would have been 71. Dr. Brown testified that there was a 94 percent probability that the defendant's I.Q. score fell within the range of 66 to 74. He agreed that the defendant's score could have been as high as 74. Dr. Brown agreed that the defendant stated that he failed the third grade because, "I just don't study and I stopped trying very hard." The witness also agreed that when the defendant was evaluated at age fifteen he reported that he enjoyed playing in the woods, riding bicycles and playing football on a community team as a tackle and defensive end. Dr. Brown stated these were not unusual past times for a fifteen-year-old boy. The following exchange also occurred:

Q. You note in your report, Doctor Brown, that Mr. Strode had been tested over a period of years in 1990, '92, '95, and '96.

A. Correct.

Q. And on everyone of tests [sic] his overall IQ scores had ranged from a high 88 to a low of 75 with two in the 78s [*11] scale?

A. Correct.

Q. All right. Is it not true, Doctor Brown, that intelligence tests are valid for the time period or the age period of which they are conducted?

A. If the instrument are found to be valid and the examiners are satisfied, the data is reliable, yes.

Q. Okay. So these scores are valid?

A. Yes, they are.

Q. Your scores, your tests was [sic] administered when Mr. Strode was 23 years of age, two years and eight months after the incident which brings us to court here, but are you saying, Doctor, that because you find an overall IQ of 69, as you stated in 2004, that we can project back and say that he had an IQ of 70 or less before he was 18 when his test scores do not show that?

A. No, I cannot say that.

. . . .

Q. . . . Are you also aware from the records provided you, Doctor Brown, that when he was admitted or placed in the Department of Correction in August of 2003, Mr. Strode was given a IQ test at that time?

A. Yes, the BETA-III.

Q. All right. On that he scores intelligence quotient of 84.

A. I thought it was 87.

. . . .

Q. The Beta-III yielded an intelligence quotient of 84, which is indicative of low average level.

A. Yes.

Q. All right, but certainly [*12] not retarded?

A. No.

Q. And that was about a year before your testing was done?

A. That's correct.

When asked about the defendant's work history, Dr. Brown agreed that the defendant had reported that he had worked as a backhoe operator, a dairy farmer, a factory worker and in the fast food industry. The defendant also reported that he wanted to get his GED and learn a trade. At the conclusion of the State's cross-examination, the following exchange occurred:

> Q. Doctor, based upon the test scores available for you for Mr. Strode prior to the time he was 18, the test scores other than your own that were given to him after he was 18, can you honestly say with a reasonable degree of psychological certainty that his, as you call it retardation had manifested itself prior to age 18?
>
> A. At least one record uses that terminology that his IQ scores dropped into the upper end of the mild range of mental retardation, with that data alone this psychologist could not render a diagnosis of mental retardation.
>
> Q. Well, what I'm saying in all of the test scores that I've seen you reference in your report, prior to age 18 showed an IQ a minimum of 75 and a high of 88.
>
> A. Correct. [*13]
>
> Q. And one in 2003 after age 18, showed an - shows in my report of 84, so based on that, the ones prior to 18, you could not say even if he was mental retarded today that it manifested itself prior to age 18, could you?
>
> A. Can't make that conclusion.
>
> Q. You can't say it?
>
> A. I can't answer your question, because the case would need further assessment. The records do not show that he met the criteria of diagnosis for mild mental retardation.
>
> Q. Prior to age 18?
>
> A. Correct.
>
> Q. Which is one of the prongs of the statute we're concerned with here today?
>
> A. Yes.

On redirect, the witness stated that the "developmental period" can be up to age 24 or 26. Dr. Brown stated that in the defendant's case, his developmental period lasted until age 24 or 26.

Dr. Eric Engum is a licenced clinical psychologist who was consulted by the State. He reviewed the tests conducted by Dr. Brown, as well as the previous psychological evaluations that Dr. Brown relied upon in his evaluation of the defendant. After reviewing all the documents provided to him, Dr.

Engum found that there was no evaluation of the defendant's I.Q. which showed he had an I.Q. lower than 70. The defendant's scores ranged [*14] from 88 to 75. A score of 75 placed the defendant in a classification known as borderline intellectual functioning, which is not the same as mental retardation. Dr. Engum testified that when comparing the WAIS-III and the BETA-III, both tests would be considered the "gold standards" for IQ tests. But, different tests have different focuses. The WAIS-III takes one and a half hours to administer while the BETA-III takes about forty-five minutes to administer. Dr. Engum also testified that the Diagnostic Statistical Manual IV states that mental retardation must occur before age eighteen. Dr. Engum could find nothing in any of the reports that indicated the presence of mental retardation before the age of eighteen. Dr. Engum did believe that there were emotional, behavioral, and possibly problems related to Attention Deficit Disorder with a learning disability. However, he believed that the majority of the defendant's problems were motivational.

Dr. Engum then testified concerning Dr. Brown's testing of the defendant. He stated that Dr. Brown's decision to throw out one of the subtests prior to scoring was against the rules of the creators of the test. The manual for the WAIS-III does [*15] provide for the substitution of one Subtest for another when the test is "spoiled." A test is spoiled if there is a disruption during the examination period. Dr. Engum did not find any reason that the defendant's test was spoiled. He also did not believe it was in the test-giver's discretion to throw out a subtest. Dr. Engum then testified regarding the scoring of the defendant's I.Q. test. Dr. Engum testified that Dr. Brown made an error in scoring the I.Q. test when dealing with the Matrix Reasoning test and actually got a higher score than he would have if the test had been scored correctly. Dr. Engum stated that when he did the recalculations, he arrived at an I.Q. score of 69. Dr. Engum stated that "to some degree Dr. Brown jumped through hoops to try to get many plague [sic] IQ and basically the mistake was made in scoring error." The result is an actual I.Q. score of 69.

Dr. Engum also testified with regard to malingering. His conclusion was different from Dr. Brown's with regard to this issue. Dr. Brown believed without a doubt that the defendant was not malingering. Dr. Engum believed that based on a few of the scores on the tests, "there are a number of performances which [*16] put [the defendant] on the borderline" as far as the defendant malingering. Dr. Engum also reiterated that this assessment did not rise to clear and convincing evidence that the defendant was malingering. But rather, there was a suggestion that he might be malingering.

At the conclusion of his testimony, Dr. Engum analyzed the three prongs of *Tennessee Code Annotated section 39-13-203(a)* with regard to the defendant. He made the following conclusion:

> Q. . . . [Y]ou've looked at the records and been provided the same information that Doctor Brown had in his summary, his report, let's go through them as to the factor of the statute that says an IQ of 70 or below prior to - by age 18, is that present?
>
> A. No, sir. He does not meet the statutory requirements for that as demonstrated across four different assessments and in each case he fell at minimum in the borderline range in one case and low average range and there is simply no support that he was mental retarded prior to age 18.
>
> Q. The second prong of the statute says there must be deficits in adaptive behavior, other than Mrs. Crawford's report concerning his activities at age 13, did you find [*17] any evidence in the records indicating that he suffered form deficits in adaptive behavior by age 18 that was associated with mental retardation?
>
> A. No, sir. And just to reiterate my earlier testimony, the assessment of his adaptive skills, abilities, and coping strategies at age 13, cannot and should not be representative of how he was functioning at age 20 or 21, it just simply can't be. It would be like saying somebody's academic development is representative at age 13 of what they're going to be like when they've gone through two years of college, you cannot equate the two. You have to wait until the person achieves that age and then actually do some type of assessment and as I said in my report and I will be very opening [sic] in saying it, it's a very difficult process to do.
>
> Number 1. to [sic] get reliable information, particularly from a client who may be sitting in a jail cell, but you may have to end up doing it anecdotically [sic]. You may end up having to do through [sic] review of records or just, you know, analysis of employment records, tax records, motor vehicle records, arrest records and so on and so forth, that may be the way you end up doing it and that [*18] administering some type of test whether it be the ABAS or the adaptive behavior skills may not be appropriate way to do it. You may have to do it anecdotically [sic].
>
> Q. And I think you have already answered the question by saying that the first two prongs of the

> statute you find no evidence that they existed in the record before you by age 18 and that is of course that is the third, this mental retardation must manifest itself by age 18, is that correct?
>
> A. You're exactly right.

Dr. Engum also testified that the developmental period according to two authoritative tests states clearly is prior to age 18. This concluded the testimony at the hearing.

At the conclusion of the hearing, the trial court determined that the defendant was mentally retarded for purposes of *Tennessee Code Annotated section 39-13-203*. The trial court's order reads as follows:

> The first prong of the statutory definition of mental retardation requires an I.Q. of seventy (70) or below. Dr. Robert Brown, Jr., testified on behalf of the defendant. He is imminently qualified and found defendant's I.Q. at the age of 23 to be 69. Dr. Eric Engum testified on the state's behalf [*19] and agreed defendant's I.Q. at age 23 was 69, even though he disagreed with some of Dr. Brown's procedures and reasoning. Dr. Brown further testified defendant would have had the same I.Q. of 69 at age 20. Defendant was 21 years of age when he was charged with the murder of Harvey Brown. Thus, defendant has established the first prong of the test.
>
> The second prong of the test for mental retardation under our statute requires "deficits in adaptive behavior" which has been defined as "the inability of an individual to behave so as to adapt to surrounding circumstances." *State v. Smith*, 893 S.W.2d 908, 918 (Tenn. 1995). Defendant's adaptive behavior deficits were established by Dr. Brown's report and by his and Ms. Crawford's testimony. The proof established defendant has significant limitations in the areas of communication, self-care, home living, social skills, self-direction, functional academics and work. Therefore, defendant has established the second prong of the statutory definition of mental retardation.
>
> The third and final prong of the test requires defendant's intellectual and adaptive deficits to "have manifested during the developmental period, or by eighteen [*20] (18) years of age." The statute therefore provides two means by which the deficits can be manifested; either (1) during this developmental period or (2) by age 18.

As to the first method, *T.C.A. § 33-1-101(17)(B)* in defining mental retardation for mental health and developmental disabilities purposes, requires that deficits in intellectual and adaptive skills "manifest before eighteen (18) years of age." This court must presume that the legislature was aware of that definition when it enacted *§ 39-13-203(a)(3)*, yet purposely chose to adopt a different definition of mental retardation to be applied in the criminal context. While the two statutes both touch upon the same subject matter, they do not contain identical provisions. This court notes that essentially, the state argues the words "or by" in *T.C.A. § 39-13-203(a)(3)*, should be read "which is defined as." Clearly, the legislature could have defined "developmental period" as between birth and the eighteenth birthday, but chose not to do so. The addition of another time frame to prove mental retardation above that required in *T.C.A. § 33-1-101(17)(B)* is indicative of the [*21] legislature's intent to have a different standard apply to defendants in a capital prosecution.

Neither the statutes nor case law in Tennessee define "developmental period." Dr. Brown defined the term in his testimony: "The developmental period, its an issue in this case, has to do with the brain and cognitive function and its birth through roughly the maturity of the brain between ages 24 and 26." Applying Dr. Brown's definition of "developmental period" which is the only definition in the proof, and accrediting Dr. Brown's report and testimony, this court finds the third prong of the test has been established. *See also 20 C.F.R. pt. 404 subpt. P, app. 12.05(C)* (defining developmental period in social security cases to be by age 22).

In the alternative, this court has considered the second method to establish the required deficits which is "by eighteen (18) years of age." The records established that the defendant's I.Q. was tested four times by age 15. No testing, however, was performed between ages 15 and 18. Although has first score at age 8 showed an I.Q. of 88, his I.Q. in 1992 at age 11 was shown to be 75. Both at age 13 and 15 the test produced an I.Q. of 78. On his 1992 [*22] report, the tester indicated that once the standard error of measurement was considered, his score may have fallen within the mild retardation range. Dr. Brown reported defendant's academic achievement decreased over time which

> he believed established a decreasing I.Q. Under all circumstances, and with the testimony and evidence of the defendant's decreasing abilities with age and his continued inability to adapt, the court finds by a preponderance of the evidence that the defendant's mental retardation manifested prior to age 18 assuming *arguendo* that such is the standard. Since defendant has established all three prongs of the test, this court finds defendant was mentally retarded as defined in T.C.A. § 39-13-203(a) at the time of the offense and is ineligible for the death penalty pursuant to T.C.A. § 39-13-203(b).

On March 23, 2005, the State requested an interlocutory appeal from the trial court's determination that the defendant was mentally retarded. The trial court and this Court granted the State's request.

ANALYSIS

The State appeals from the trial court's determination that the defendant was ineligible [*23] for the death penalty because he was considered to be mentally retarded under the definition provided in Tennessee Code Annotated section 39-13-203(a). The State argues three issues: (1) the trial court incorrectly determined that Tennessee Code Annotated section 39-13-203 allows for the manifestation of mental retardation past the age of eighteen; (2) there is no proof in the record to support the trial court's finding that the defendant had an I.Q. of 70 or below prior to his eighteenth birthday; and (3) the evidence preponderates against the trial court's finding that the defendant suffered deficits in adaptive behavior prior to his eighteenth birthday.

HN1 For a defendant to be found mentally retarded and therefore ineligible for the death penalty, he must meet the definition for mental retardation as provided in Tennessee Code Annotated section 39-13-203. This statute states:

> (a) ***HN2*** As used in this section, "mental retardation" means:
>
> (1) Significantly subaverage general intellectual functioning as evidenced by a functional intelligance quotient (I.Q.) Of seventy (70) or below;
>
> (2) Deficits [*24] in adaptive behavior; and
>
> (3) The mental retardation must have been manifested during the developmental period, or by eighteen (18) years of age.

Tenn. Code Ann. § 39-13-203(a). Shortly after the enactment of Tennessee Code Annotated section 39-13-203, our supreme court held in Van Tran v. State, 66 S.W.3d 790 (Tenn. 2001) that ***HN3*** the execution of mentally retarded defendants constitutes cruel and unusual punishment under the constitutions of both the United States and the State of Tennessee. 66 S.W.3d at 809. [2] The burden of persuasion to demonstrate that he is mentally retarded is on the defendant, and the trial court must determine by the preponderance of the evidence whether a defendant is indeed mentally retarded. Tenn. Code Ann. § 39-13-203(c). The question of whether an individual is mentally retarded for purposes of application of the death penalty is a mixed question of law and fact. Therefore, the trial court's findings must be reviewed with a presumption of correctness and only reversed when the preponderance of the evidence is contrary to the findings [*25] of the trial court. Fields v. State, 40 S.W.3d 450, 456 (Tenn. 2001). When reviewing the application of the law to the facts, this court must conduct a purely *de novo* review. Id. at 457.

Statutory Interpretation

The State first argues that the trial court incorrectly determined that Tennessee Code Annotated section 39-13-203(a)(3) allows for the manifestation of mental retardation past the age of eighteen. The defendant argues that the inclusion of the phrase "developmental period, or by eighteen (18) years of age" in the statute allows for the trial court's extrapolation that the developmental period can extend beyond the age of eighteen. Therefore the [*26] questions presented is what is meant by the phrase "developmental period, or age eighteen (18)" as stated in Tennessee Code Annotated section 39-13-203(a). Because this ***HN5*** question is an interpretation of a statute, it is purely a question of law and is subject to a *de novo* review.

HN6 Generally, when construing a statute, every word within the statute is presumed to "have meaning and purpose and should be given full effect." State v. Odom, 928 S.W.2d 18, 29-30 (Tenn. 1996) (quoting Marsh v. Henderson, 221 Tenn. 42, 424 S.W.2d 193, 196 (Tenn. 1968)). This Court's primary duty in construing a statute is "to ascertain and give effect to the legislative intent without unduly

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[2] See also, Atkins v. Virginia, 536 U.S. 304, 122 S. Ct. 2242, 153 L. Ed. 2d 335 (2002) (holding ***HN4*** the ***Eighth Amendment to the United States Constitution*** which prohibits "cruel and unusual punishment" precludes the death penalty for persons adjudicated mentally retarded.

restricting or expanding a statute's coverage beyond its intended scope." *Owens v. State, 908 S.W.2d 923, 926 (Tenn. 1995)*; *see also State v. Davis, 940 S.W.2d 558, 561 (Tenn. 1997)*. Legislative intent should be gleaned from the "natural and ordinary meaning of the language used, without a forced or subtle construction that would limit or extend the meaning of the language." *Carter v. State, 952 S.W.2d 417, 419 (Tenn. 1997)*. [*27] Furthermore, this Court should construe a statute so that its component parts are consistent and reasonable, and inconsistent parts should be harmonized, where possible. *State v. Odom, 928 S.W.2d at 30*.

In its order, the trial court determined that a defendant could be found to be mentally retarded under *Tennessee Code Annotated section 39-13-203(a)(3)* because the term "developmental period" lasted until age twenty-four and was a separate time period during which mental retardation could manifest under the statute. The trial court relied in part upon the definition of mental retardation found at *Tennessee Code Annotated section 33-1-101(17)(B)* which states that mental retardation must manifest by age eighteen. The trial court stated that this statute was in effect at the time the legislature enacted *Tennessee Code Annotated section 39-13-203*, and by including the phrase "developmental period" the legislature intended to give trial courts an alternative for the diagnosis period beyond the age of eighteen when determining eligibility for capital sentencing. The trial court also relied [*28] upon the testimony of the defendant's expert witness, Dr. Brown who stated that the developmental period can last up to age twenty-four. The trial court stated that Dr. Brown's definition of developmental period was the only definition submitted into evidence. However, in our review of the record we found that Dr. Engum also testified as to the definition of developmental period with regard to the diagnosis of mental retardation. Dr. Engum stated that under two tests used to diagnose mental retardation "developmental period" was defined as up to age eighteen.

We first look at the plain meaning of the words used in the statute. The legislature stated that mental retardation must have "manifested during the developmental period, or by age eighteen (18)." From a standpoint of the natural and ordinary meaning of the words, it would appear that the age of eighteen would be the cutoff point for diagnosis. If the legislature had intended the developmental period to extend beyond age eighteen, the statute would state a later age. In addition, the wording of the statute leads one to conclude that "developmental period" is shorter than eighteen years. One would assume that a time period longer [*29] than eighteen years would be implied by wording which read, "by the age or eighteen, or during the developmental period."

In *Van Tran v. State, 66 S.W.3d 790 (Tenn. 2001)*, our supreme court analyzed *Tennessee Code Annotated section 39-13-203*. In analyzing the definition of mental retardation the court referenced the definition included in the Diagnostic and Statistical Manual of Mental Disorders ("DSM-IV") and stated, "[l]ike the statutory definition, the DSM-IV requires that the intellectual and adaptive deficits manifest themselves by the time the person is eighteen years of age." *Van Tran, 66 S.W.3d at 795*.

In *State v. Howell, 151 S.W.3d 450 (Tenn. 2004)*, our supreme court recently analyzed the definition of mental retardation under *Tennessee Code Annotated section 39-13-203*. The court first stated that mental retardation is very difficult to define, and that this has been admitted by the United States Supreme Court. *Howell, 151 S.W.3d at 457*. Our supreme court then outlined the prevailing definition of mental retardation as, "significantly subaverage [*30] intellectual functioning accompanied by related limitations in two or more adaptive skill areas . . . and manifestation of the condition before age 18." *Howell*, *151 S.W.3d at 457*. The supreme court also stated that this is the definition quoted by the United State Supreme Court from the American Association of Mental Retardation and the American Psychiatric Association and included in the Supreme Court's opinion in *Atkins v. Virginia, 536 U.S. 304, 308 n.3, 122 S. Ct. 2242, 153 L. Ed. 2d 335 (2002)*.

Our supreme court then went on to further analyze *Tennessee Code Annotated section 39-13-203* comparing the definition of mental retardation included in *Tennessee Code Annotated section 33-1-101(17)*. This statute concerns the State's providing of social services and is the same statute that the trial court relied upon in reaching its conclusion in the case *sub judice*. In *Howell*, our supreme court stated:

> As is evident, [*Tennessee Code Annotated section 33-1-101(17)*] contains no reference to numerical I.Q. scores and is therefore less restrictive than *Tennessee Code Annotated section 39-13-203(a)*. Additionally, [*31] *section 33-1-101(17)* was in existence at the time the legislature enacted *section 39-13-203(a)*. Therefore, we must presume the legislature was aware of *section 33-1-101(17)*, yet purposely chose to adopt a different definition of mental retardation to be applied in the criminal context. That the two statutes both touch upon the same subject matter, yet contain dissimilar provisions, is *indicative of a legislative intent to have a different, more restrictive standard apply to defendant in a capital prosecution*.

Howell, 151 S.W.3d at 458 (emphasis added).

Clearly, our supreme court interprets the language, "during the developmental period, or by eighteen" included in *Tennessee Code Annotated section 39-13-203* as not including the years past the age of eighteen. Therefore, we conclude that our supreme court interprets *Tennessee Code Annotated section 39-13-203(a)* as requiring that mental retardation manifest before the age of eighteen.

This conclusion is also supported by the legislative history for *Tennessee Code Annotated section 39-13-203*. Roger Blue, an expert in mental [*32] retardation, testified at the Senate Judiciary Committee hearings on the statute. Mr. Blue stated:

> The definition as spelled out in this legislation is the accepted definition of the American Association on Mental Retardation, which is a universally accepted definition used in the field. The substantial subaverage intelligence is one of three things that have to exist for someone to be considered to - have mental retardation as opposed to other types of handicaps. The reference to subaverage intelligence, the general level I.Q. used in testing . . . generally the I.Q. of 70 and below is considered to be substantially subaverage intelligence. It also has to be accompanied by - a deficit in adaptive behavior. *It also has to have occurred during the developmental years, which means you are either born with it or in early childhood develop it.*

Tenn. Sen. Jud. Comm., *Debate on House Bill 1851*, March 13, 1990 (emphasis added). "Developmental period" according to this expert is restricted to early childhood. It is reasonable to assume that the senators at the hearing would assume that the term "developmental period" referred to early childhood. In another exchange [*33] during debate in the House Judiciary Committee, The sponsor of the bill defined mental retardation as occurring during "the developmental period under eighteen years of age." Tenn. House Jud. Comm., *Debate on House Bill 2107*, March 13, 1990. Also at this debate, a legislator asked the sponsor of the bill why it was important that the defendant be diagnosed before age eighteen. The sponsor of the bill replied, "Ninety-nine percent are diagnosed before age eighteen years of age. This is a defect that you are born with for the most part." *Id.* In debate at the General Assembly, The sponsor repeatedly stated that mental retardation must manifest itself before the defendant's eighteenth birthday and that it is a birth defect. Tenn. House, *Debate on House Bill 2107*, April 5, 1990. When discussing potential retroactive diagnosis of defendants with mental retardation the sponsor emphasized the cut-off of eighteen years of age when he stated, "[the defendant] would have to be able to show retroactively, however, through expert testimony, that he is in fact mentally retarded and that condition existed prior to his eighteenth birthday. . . . It would have to have been manifested [*34] before his eighteenth birthday. . . ." *Id.*

It does not appear that the legislature intended for the term "developmental period" to extend beyond eighteen years of age.

We have also looked at other states' definitions of mental retardation with reference to application of the death penalty and when they require that symptoms must manifest themselves. A few states' statutes include the term developmental period and specifically state that it ends at eighteen. *Ark. Code Ann. § 5-4-618(a)(1)*; *Conn. Gen. Stat. § 1-1g*; *Wash. Rev. Code § 10.95.030(2)(e)*. Many other states' statutes simply set out eighteen years of age as the cut off. *Ariz. Rev. Stat. Ann. § 13-703.02* K. 2; *Del. Code Ann. tit. 11 § 4209(d)(1)*; *Fla. Stat. § 921.137(1)*; *Idaho Code Ann. § 19-2515A(1)(a)*; *Kan. Stat. Ann. § 76-12b01(d)*; *Mo. Rev. Stat. § 565.030*; *N.C. Gen. Stat. § 15A-2005(a)(1)*.

Other states refer to the developmental period in the [*35] statute, but there is no definition of developmental period included in the statute. *Ala. Code § 15-24-2*; *Cal. Penal Code § 1001.20(a)(1)*; *Colo. Rev. Stat. § 18-1.3-1101(2)*; *Ga. Code Ann. § 17-7-131(a)(3)*; *730 Ill. Comp. Stat. § 5/5-1-13*; *Ky. Rev. Stat. Ann. § 532.130(2)*; *Nev. Rev. Stat. § 174.098(7)*; *S.C. Code Ann. § 16-3-20*. Alabama is one of those states. The Alabama Supreme Court has interpreted "developmental period" to mean ending at eighteen, "these problems must have manifested themselves during the developmental period (i.e., before the defendant reached age 18)." *Ex parte Perkins, 851 So. 2d 453, 456 (Ala. 2002)*. There are also a small number of states that use the age of twenty-two as a cut off for the manifestation of symptoms. *Ind. Code Ann. § 35-36-9-2*; *Md. Code Ann., Crim. Law § 2-202(b)(1)(ii)*; *Utah Code Ann. § 77-15a-102(2)*.

We have attempted [*36] to find other states who have had similar questions with regard to their statutes. It appears that this issue has rarely, if ever been addressed. In an Oklahoma case, the Court of Criminal Appeals of Oklahoma stated: "[w]hile literature indicates the disability manifests 'during the developmental period,' legislatures, and now the Supreme Court, have extended the manifestation to prior to the 18th birthday. This elongated period of discovery gives the benefit of proof to the charged offender. . . ." *Murphy v. State, 2003 OK CR 6, 66 P.3d 456, 460 (Okla. Crim. App. 2003)*. Our research leads to the conclusion that the majority

of states consider the developmental period to end at eighteen.

We conclude that the trial court's interpretation of the phrase "developmental period, or by age eighteen," is incorrect. ***HN7*** For a defendant to meet the third prong of *Tennessee Code Annotated section 39-13-203(a)*, the symptoms of mental retardation must have manifested by the age of eighteen. This conclusion is supported by previous opinions of the Tennessee Supreme Court, as well as the legislative history of this statute, the statutes and caselaw of other [*37] states, and the DSM-IV, which is the main diagnostic manual in the psychiatric field.

Proof of Below 70 I.Q. Before the Age of Eighteen

Having determined that the statute does indeed require that the symptoms manifest themselves before the age of eighteen, we now turn to the first prong of *Tennessee Code Annotated section 39-13-203(a)* which requires that the defendant have, "[s]ignificantly subaverage general intellectual functioning as evidenced by a functional intelligence quotient (I.Q.) of seventy (70) or below." *Tenn. Code Ann. § 39-13-202(a)(1)*. The trial court appears to have determined that this prong was met because the defendant had an I.Q. of 69 at the age of 23. The trial court also stated that the defendant's expert witness testified that the defendant's I.Q. at 20, the time of the incident, would have been the same. The trial court also stated in the alternative that an earlier tester of the defendant's I.Q. stated that, adjusted for the margin of error, the defendant's score may have fallen within the mild mentally retarded range.

The State argues that "the defendant never received an I.Q. score [*38] below 70 until he was incarcerated and facing first degree murder." The defendant argues that his I.Q. scores decreased over time and there were no scores available for the years between when he was fifteen and eighteen. Furthermore, the defendant states that he scored a 69 at 23 years of age.

The evidence showed that the defendant had been evaluated on more than one occasion for the purpose of establishing his I.Q. In 1990 at the age of eight the defendant scored an 88 on an I.Q. test. In 1992 at the age eleven he scored 75. In 1995 and in 1996 at the ages of thirteen and fifteen he scored 78 both times. There were no additional I.Q. tests administered before the age of eighteen.

Obviously, there are no I.Q. scores for the defendant before the age of eighteen which are below 70 as required by the statute. The trial court states that one earlier tester stated that the defendant's score could fall within the mildly mentally retarded range when adjusted for the margin of error. However, our supreme court previously held that *Tennessee Code Annotated section 39-13-203(a)* does not provide for a measurement of errors and therefore, the score of 70 is a "clear [*39] objective guideline to be followed by the courts when applying the three-prong test. . . ." *Howell, 151 S.W.3d at 458*. There is no evidence in the record that the defendant had an I.Q. below 70 before he reached the age of eighteen.

The Court faced a similar set of facts in *Byron Lewis Black v. State, 2005 Tenn. Crim. App. LEXIS 1129, No. M2004-01345-CCA-R3-PD, 2005 WL 2662577 (Tenn. Crim. App., at Nashville, Oct. 19, 2005), perm. app. denied*, (Tenn. Feb. 21, 2005). In *Byron Lewis Black*, the petitioner's I.Q. had been tested before he reached the age of eighteen. He scored above 70 in every I.Q. test before he reached eighteen. It was only after he became an adult and was over eighteen that his I.Q. scores began to be below 70. We held that the record did not support the proposition that the petitioner had an I.Q. score below that of 70 before the age of eighteen. *Byron Lewis Black, 2005 Tenn. Crim. App. LEXIS 1129, 2005 WL 2662677, at *17*.

The same is true in the case *sub judice*. There is absolutely no proof in the record that the defendant had an I.Q. score below 70 before he reached the age of eighteen. Therefore, the evidence preponderates against the findings of the trial [*40] court.

Deficits in Adaptive Behavior Before the Age of Eighteen

The State also argues that the evidence preponderates against the trial court's findings that the defendant suffered from deficits in his adaptive behavior before the age of eighteen. We note that *Tennessee Code Annotated section 39-13-203(a)* requires that all three prongs be satisfied in order for a defendant to meet the definition of mental retardation. Because we have already determined that the defendant has not met the burden of proof required for the first prong, that he have an I.Q. below 70 before age eighteen, it is impossible for him to prove that he is mentally retarded under the definition provided in *Tennessee Code Annotated section 39-13-203(a)*. However, out of a sense of judicial economy, we will nonetheless review this issue for purposes of judicial efficiency.

The trial court relied upon Dr. Brown's report and the testimony of Ms. Crawford to determine that the defendant did indeed suffer from deficits in adaptive behavior. However, we note that Dr. Brown's main source for information for the defendant's adaptive behavior prior to eighteen [*41] was an interview with Ms. Crawford.

Our supreme court relied upon the definitions in the DSM-IV to define what is meant by the statute's requirement of deficits in adaptive behavior. *Van Tran, 66 S.W.3d at 795*. In *Van Tran*, the supreme court stated:

> The second part of the definition-adaptive functioning-"refers to how effectively individuals cope with common life demands and how well they meet the standards of personal independence expected of someone in their particular age group, sociocultural background, and community setting." [American Psychiatric Association, *Diagnostic and Statistical Manual of Mental Disorders*, 39,] 40 [(4th ed. 1994)]. As discussed, a mentally retarded person will have significant limitations in at least two of the following basic skills: "communication, self-care, home living, social/interpersonal skills, use of community resources, self-direction, functional academic skills, work, leisure, health, and safety." *Id.* at 39. Influences on adaptive functioning may include the individual's "education, motivation, personality characteristics, social and vocational opportunities, and the mental disorders and general medical [*42] conditions that may coexist with Mental Retardation." *Id.* at 40.

Id.

As we stated above, Dr. Brown testified that the defendant's adaptive behavior was not formally evaluated when he was a child, so he had to rely on his interview with Ms. Crawford. Ms. Crawford testified that she had the defendant in her house for about two years. She stated that he did not make friends easily and had problems with his hygiene. Ms. Crawford told Dr. Brown that when the defendant was living with her, she came to the conclusion that the defendant would never be able to live on his own. Ms. Crawford also stated that when he left her house he was about fourteen years old, and she only had one visit with him before he was arrested for the incident in question. Dr. Brown also relied upon a report from a youth home in Memphis, where the defendant lived after leaving Ms. Crawford's house. That report stated that the defendant's clinical supervisor did not believe that the defendant would be able to live independently. There was also evidence that the defendant had trouble in school.

Dr. Engum concluded that it was unlikely that the defendant had deficits in adaptive behavior. Dr. Engum relied [*43] on the fact that the defendant was able to hold several jobs, such as backhoe operator, a dairy farmer, a factory worker, a fast food worker and a baby-sitter. In addition, the defendant had obtained his driver's license, saved money to purchase a car, and establish some type of living situation.

The trial court held, "The proof established defendant has significant limitations in the areas of communication, self-care, home living, social skills, self-direction, functional academics and work." We find that the evidence presented at trial preponderates against the findings of the trial court. There was not evidence to support deficiencies in all the areas listed by the trial court. As we stated above, the DSM-IV requires deficiencies in only two of the listed areas.

To prove deficiencies in at least two areas, Dr. Brown relied upon the recollections of Ms. Crawford. We question the reliability of the information for diagnosis purposes when Ms. Crawford cared for the defendant for two years from the time he was eleven until he was fourteen. Common experience tells us very few fourteen-year-old children are capable of living on their own. Such experience also informs us that many fourteen-year-olds [*44] do not take pains to bathe, dress in presentable clothes, or brush their teeth. There were no formal evaluations completed on the defendant before he turned eighteen. We are unable to conclude from the evidence presented at the hearing that the defendant had adaptive deficits prior to the age of eighteen in two of the basic skills listed in the DSM-IV. This is especially true considering his ability to care for himself, work and obtain a driver's license as an adult. Therefore, the evidence preponderates against the findings of the trial court.

CONCLUSION

For the foregoing reasons, we reverse the judgement of the trial court and remand for further proceedings in accordance with this opinion.

JERRY L. SMITH, JUDGE

Bellsouth Bse v. Tenn. Regulatory Auth.

Court of Appeals of Tennessee, at Nashville

February 18, 2003, Filed

No. M2000-00868-COA-R12-CV

Reporter
2003 Tenn. App. LEXIS 123; 2003 WL 354466

BELLSOUTH BSE, INC. v. TENNESSEE REGULATORY AUTHORITY

Prior History: [*1] Tenn. R. App. P. 12 Appeal as of Right; Judgment of the Tennessee Regulatory Authority Vacated and Remanded. Tennessee Regulatory Authority. No. 98-00879.

Disposition: Judgment of the Tennessee Regulatory Authority vacated and remanded.

Core Terms

affiliate, services, requirements, incumbent, provider, certification, floor, Telecommunications, telecommunications service, competitive, regulation, safeguards, anticompetitive, intervenors, interLATA, practices, carriers, entities, network, local service, statewide, operating company, rates, local telephone, provisions, public interest, operations, costs, nondiscriminatory, interconnection

Case Summary

Procedural Posture

Appellant telephone company applied for certification as a competing local exchange company (CLEC) on a Statewide basis. The Tennessee Regulatory Authority (TRA) granted the telephone company's authority to provide local services in those territories where its affiliate was not the incumbent provider of local services, but denied its application in those areas where its affiliate was providing local service. The telephone company appealed.

Overview

Because the TRA denied the petition on the basis that the certification would be inconsistent with the goal of fostering competition and could be potentially adverse to competition, as opposed to establishing conditions or requirements designed to ensure that anticompetitive practices did not occur, the appellate court vacated the order as beyond the agency's statutory authority. The appellate court found that the telephone company met the requirements for certification as a competing provider under *Tenn. Code Ann. § 65-4-201(c)* by demonstrating: (1) that it would adhere to all applicable TRA policies, rules, and orders; and (2) that it possessed managerial, financial, and technical abilities to provide the services. The appellate court agreed with the TRA that it had the authority under *Tenn. Code Ann. § 65-4-201(a)* to consider the effect on competition of an application for statewide certification as a CLEC. TRA also had specific authority to adopt rules or issue orders to prohibit anticompetitive practices under Tenn. Code Ann. § 65-5-208(c). However, the appellate court found that the statute prohibited anticompetitive conduct, not affiliation relationships.

Outcome

The judgment of the TRA was vacated and remanded.

LexisNexis® Headnotes

Communications Law > Federal Acts > Telecommunications Act > General Overview

Communications Law > ... > Telephone Services > Local Exchange Carriers > General Overview

HN1 The adoption of the Tennessee Telecommunication Act, 1995 Tenn. Pub. Acts 408 (effective 6 June 1995), abolished monopolistic control of local telephone service and opened that market to competition. It also changed the way in which providers of such services, and the rates they charge, were regulated.

Antitrust & Trade Law > Regulated Industries > Communications > State Regulation

Business & Corporate Compliance > ... > Federal Versus State Law > Intrastate Communications > State Regulation of Intrastate Communications

Communications Law > ... > Telephone Services > Local Exchange Carriers > General Overview

HN2 As part of the implementation of local service competition, a company which was providing basic local exchange telephone service, as defined by statute, prior to 6 June 1995, is designated as the "incumbent local exchange telephone company," or ILEC. *Tenn. Code Ann. § 65-4-101(d)*. New entrants into the market after 6 June 1995, are known as "competing telecommunications service providers" or CLECs. *Tenn. Code Ann. § 65-4-101(e)*. To become a CLEC, a provider is required to be certificated pursuant to *Tenn. Code Ann. § 65-4-201*.

Communications Law > ... > Telephone Services > Local Exchange Carriers > General Overview

HN3 See *Tenn. Code Ann. § 65-4-201(c)*.

Antitrust & Trade Law > Regulated Industries > Communications > Telecommunications Act

Communications Law > Federal Acts > General Overview

Communications Law > Federal Acts > Telecommunications Act > General Overview

Communications Law > ... > Telephone Services > Local Exchange Carriers > General Overview

HN4 By enactment of the Telecommunications Act of 1996, Congress made fundamental changes in local telephone markets by, among other things, prohibiting states from enforcing laws that impede competition. In order to facilitate the transition from regulated monopolies to true competition, the Act imposes upon the incumbent local exchange telephone company provider or ILEC, who formerly enjoyed the monopoly, a number of duties intended to facilitate entry into the market by other, formerly excluded, providers.

Antitrust & Trade Law > Regulated Industries > Communications > State Regulation

Antitrust & Trade Law > Regulated Industries > Communications > Telecommunications Act

Communications Law > Federal Acts > Telecommunications Act > General Overview

Communications Law > Federal Acts > Telecommunications Act > Federal Preemption

Communications Law > ... > Telephone Services > Local Exchange Carriers > General Overview

Communications Law > ... > Regulated Practices > Introducing Competition > Duties of Incumbent Carriers & Resellers

Communications Law > ... > Orders & Hearings > Complaints & Charges > Rates

Contracts Law > Types of Contracts > Lease Agreements > General Overview

HN5 The 1996 Act brought sweeping changes. It ended the monopolies that incumbent LECs held over local telephone service by preempting state laws that had protected the LECs from competition. See *47 U.S.C. § 253*. Congress recognized, however, that removing the legal barriers to entry would not be enough, given current technology, to make local telephone markets competitive. In other words, it is economically impractical to duplicate the incumbent LEC 's local network infrastructure. To get around this problem, the Act allows potential competitors, called competing local exchange carriers (CLECs), to enter the local telephone market by using the incumbent LEC 's network or services in three ways. First, a CLEC may build its own network and "interconnect" with the network of an incumbent. See id. *§ 251(c)(2)*. Second, a CLEC may lease elements (loops, switches, etc.) of an incumbent LEC 's network "on an unbundled basis." See id. *§ 251(c)(3)*. Third, a CLEC may buy an incumbent LEC 's retail services "at wholesale rates" and then resell those services to customers under its (the CLEC's) brand. See id. *§ 251(c)(4)*.

Communications Law > Federal Acts > Telecommunications Act > General Overview

Communications Law > ... > Telephone Services > Local Exchange Carriers > General Overview

Communications Law > ... > Regulated Practices > Introducing Competition > Duties of Incumbent Carriers & Resellers

Communications Law > ... > Regulated Practices > Introducing Competition > Interconnection Agreements

HN6 This access is accomplished through an interconnection agreement between the ILEC and a CLEC. In addition, an ILEC is required to provide access to its network elements and various services and to provide dialing parity to competing providers on a nondiscriminatory basis. *47 U.S.C.S. §§ 251(c)(3)* & *251(b)(3)*. The FCC has promulgated rules and policies implementing those provisions "to require incumbent LECs to provide competition with access to the incumbent LECs' networks sufficient to create a competitively neutral playing field for new entrants.

Communications Law > ... > Telephone Services > Local Exchange Carriers > General Overview

HN7 Under state law, all providers are required to provide non-discriminatory interconnection to their public networks under reasonable terms and conditions, and all are to be provided "desired features, functions and services promptly,

and on an unbundled and non-discriminatory basis from all other telecommunications providers." *Tenn. Code Ann. § 65-4-124(a)*.

Communications Law > ... > Telephone Services > Local Exchange Carriers > General Overview

HN8 At the state level, incumbent providers are also governed by specific provisions, again designed to facilitate entry into the local telephone service market by competitors. For example, rates to be charged by incumbent providers opting to be under a price regulation plan are subject to a requirement that such rates be just and reasonable, defined as "affordable", as determined by the TRA. Tenn. Code Ann. § 65-5-209(a). These rates are subject to limitations, including safeguards to ensure universal service and nondiscrimination among customers. Tenn. Code Ann. § 65-5-209(b).

Communications Law > ... > Telephone Services > Local Exchange Carriers > General Overview

Communications Law > ... > Orders & Hearings > Complaints & Charges > Rates

HN9 After the initial qualification of a price regulation plan, an ILEC's ability to increase rates is subject to limitations. Essentially, a price regulated ILEC can adjust rates for specific services subject to an overall maximum annual adjustment to aggregate revenues for such services. Tenn. Code Ann. § 65-5-209(e). However, rates for basic services cannot be increased for four (4) years after implementation of the plan, and annual increases for basic services are thereafter limited to annual rates of inflation. Tenn. Code Ann. § 65-5-209(f).

Communications Law > ... > Telephone Services > Local Exchange Carriers > General Overview

Communications Law > ... > Orders & Hearings > Complaints & Charges > Rates

HN10 ILECs not under a price regulation plan are subject to traditional rate regulation. ILECs have unique, carrier-of-last-resort obligations and universal service obligations. Tenn. Code Ann. § 65-5-207(c)(2) & (8). ILECs, upon request, are required to provide interconnection services to CLECs. Tenn. Code Ann. § 65-5-209(d). None of these burdens apply to CLECs.

Communications Law > ... > Telephone Services > Local Exchange Carriers > General Overview

HN11 See Tenn. Code Ann. § 65-5-208(c).

Business & Corporate Compliance > ... > Federal Versus State Law > Intrastate Communications > State Regulation of Intrastate Communications

Communications Law > ... > Telephone Services > Local Exchange Carriers > General Overview

HN12 Tenn. Code Ann. § 65-5-207 authorizes the TRA to establish policies, rules, and orders requiring all telecommunications service providers to contribute to the support of universal service, which consists of residential basic local exchange telephone service at affordable rates and carrier-of-last-resort obligations.

Communications Law > Federal Acts > Telecommunications Act > General Overview

Communications Law > ... > Telephone Services > Local Exchange Carriers > General Overview

HN13 *47 U.S.C.S. § 272 (a)* provides that a Bell Operating Company or BOC (including any affiliate) that is a local exchange carrier (LEC) subject to the requirements of *47 U.S.C.S. § 251(c)* may provide certain services only through a separate affiliate. Under *47 U.S.C.S. § 272* , BOCs (or BOC affiliates) may engage in the following activities only through one or more affiliates that are separate from the incumbent LEC entity: (A) manufacturing activities; (B) interLATA telecommunications services that originate in-region; and (C) interLATA information services.

Administrative Law > Judicial Review > Standards of Review > General Overview

Administrative Law > Judicial Review > Standards of Review > Arbitrary & Capricious Standard of Review

Business & Corporate Compliance > ... > Federal Versus State Law > Intrastate Communications > State Regulation of Intrastate Communications

Energy & Utilities Law > Utility Companies > General Overview

HN14 The Tennessee Regulatory Authority cannot apply legal requirements arbitrarily or capriciously and must have a factual basis for its actions. *Tenn. Code Ann. § 4-5-322(h)*.

Communications Law > Federal Acts > Telecommunications Act > General Overview

Communications Law > ... > Telephone Services > Local Exchange Carriers > General Overview

HN15 *47 U.S.C.S. § 272* does not prohibit a *47 U.S.C.S. § 272* affiliate from providing local exchange services in addition to interLATA services, nor can such a prohibition be read into this section.

Administrative Law > Judicial Review > Standards of Review > Arbitrary & Capricious Standard of Review

Administrative Law > Judicial Review > Standards of Review > Substantial Evidence

HN16 See *Tenn. Code Ann. § 4-5-322(h)*.

Administrative Law > Judicial Review > Standards of Review > Substantial Evidence

HN17 In determining the substantiality of evidence, an appellate 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.

Administrative Law > Separation of Powers > Jurisdiction

Administrative Law > Separation of Powers > Legislative Controls > General Overview

Business & Corporate Compliance > ... > Federal Versus State Law > Intrastate Communications > State Regulation of Intrastate Communications

Energy & Utilities Law > Regulators > Public Utility Commissions > General Overview

HN18 The Tennessee Regulatory Authority (TRA) may exercise only that authority given it expressly by statute or arising by necessary implication from an express grant. The General Assembly has given the TRA practically plenary authority over the utilities within its jurisdiction. The TRA has "general supervisory and regulatory power, jurisdiction, and control over all public utilities." *Tenn. Code Ann. § 65-4-104*. The General Assembly has given the TRA, in addition to other jurisdiction conferred, the authority to "investigate, hear and enter appropriate orders to resolve all contested issues of fact or law arising as a result of the application of Acts 1995, ch. 408 (the Tennessee Telecommunications Act)." Tenn. Code Ann. § 65-5-210(a).

Antitrust & Trade Law > Regulated Industries > Communications

Antitrust & Trade Law > Regulated Industries > Communications > State Regulation

HN19 See *Tenn. Code Ann. § 65-4-123*.

Antitrust & Trade Law > Regulated Industries > Communications

Antitrust & Trade Law > Regulated Industries > Communications > General Overview

Antitrust & Trade Law > Regulated Industries > Communications > State Regulation

Communications Law > Federal Acts > General Overview

Communications Law > Federal Acts > Telecommunications Act > General Overview

Business & Corporate Compliance > ... > Federal Versus State Law > Intrastate Communications > State Regulation of Intrastate Communications

HN20 In the preamble to the Tennessee Telecommunications Act, the General Assembly stated a policy that "Competition among providers should be made fair by requiring that all regulation be applied impartially and without discrimination to each." 1995 Tenn. Pub. Acts ch. 408.

Antitrust & Trade Law > Regulated Industries > Communications > General Overview

Antitrust & Trade Law > Regulated Industries > Communications > Telecommunications Act

Communications Law > Federal Acts > Telecommunications Act > General Overview

HN21 Federal law places a duty on the Tennessee Regulatory Authority to promote or insure competition in the provision of telecommunication services.

Communications Law > Federal Acts > Telecommunications Act > General Overview

Business & Corporate Compliance > ... > Federal Versus State Law > Intrastate Communications > State Regulation of Intrastate Communications

Transportation Law > Intrastate Commerce

HN22 See *47 U.S.C.S. § 253*.

Antitrust & Trade Law > Regulated Industries > Communications > General Overview

Antitrust & Trade Law > Regulated Industries > Communications > Telecommunications Act

Communications Law > Federal Acts > Telecommunications Act > General Overview

Communications Law > ... > Telephone Services > Local Exchange Carriers > General Overview

HN23 The 1996 Telecommunications Act has special provisions relating to a Regional Bell Operating Company (RBOC). Because RBOCs had gained control of the local telephone services markets through a monopoly, such measures were considered necessary if true competition were to develop as a practical matter.

Antitrust & Trade Law > Regulated Industries > Communications > General Overview

Antitrust & Trade Law > Regulated Industries > Communications > State Regulation

Business & Corporate Compliance > ... > Federal Versus State Law > Intrastate Communications > State Regulation of Intrastate Communications

Communications Law > ... > Regulated Entities > Telephone Services > General Overview

Communications Law > ... > Telephone Services > Local Exchange Carriers > General Overview

HN24 The Federal Communications Commission recognizes the authority of State regulatory agencies to treat certain Bell operating companies (BOC) related entities differently because of the potential impact on competition in the telecommunications industry.

Antitrust & Trade Law > Regulated Industries > Communications > General Overview

Communications Law > ... > Telephone Services > Local Exchange Carriers > General Overview

HN25 As a matter of policy, regulations prohibiting Bell operating companies (BOC) affiliates from offering local telephone exchange service do not serve the public interest.

Antitrust & Trade Law > Regulated Industries > Communications > General Overview

Business & Corporate Compliance > ... > Federal Versus State Law > Intrastate Communications > State Regulation of Intrastate Communications

Communications Law > ... > Telephone Services > Local Exchange Carriers > General Overview

HN26 While Tenn. Code Ann. § 65-5-208(c) authorizes the Tennessee Regulatory Authority (TRA) to implement safeguards to prohibit anticompetitive conduct between an incumbent local exchange telephone company (ILEC) and its affiliated competing telecommunications service providers or CLECs, there is nothing in the statute to authorize the TRA to deny certification of a related entity simply because, by its nature, the affiliate relationship may provide the opportunity for anticompetitive practices. The legislature has prohibited anticompetitive conduct, not affiliation relationships. The TRA's responsibility in that situation is to put in place standards or requirements to prohibit and prevent the anticompetitive possibilities from becoming realities and/or to make violations easier to discover so that regulation is effective.

Counsel: Guilford F. Thornton, Jr., Nashville, Tennessee, for the appellant, Bellsouth BSE, Inc.

Henry Walker, Nashville, Tennessee, for the appellees, MCI WorldCom, Southeastern Competitive Carriers Association, Time Warner Communications of the South, L.P. and US LEC of Tennessee, Inc.

J. Richard Collier, Jonathan N. Wike, Nashville, Tennessee, for the appellee, Tennessee Regulatory Authority.

Judges: PATRICIA J. COTTRELL, J., delivered the opinion of the court, in which BEN H. CANTRELL, P.J., M.S., and WILLIAM C. KOCH, JR., joined.

Opinion by: PATRICIA J. COTTRELL

Opinion

BellSouth BSE, Inc. appeals from an order of the Tennessee Regulatory Authority denying BSE's application for certification as a competing local exchange company in those areas where BSE's affiliate, BellSouth Telecommunications, is the incumbent provider of local services. Because the TRA denied the petition on the basis that such certification may be inconsistent with the goal of fostering competition [*2] and could be potentially adverse to competition, as opposed to establishing conditions or requirements designed to ensure that anticompetitive practices did not occur, we vacate the order as beyond the agency's statutory authority.

Before the state legislature made significant changes in the law governing telecommunications services in 1995, local telephone service was provided to consumers in a locality by one company under a regulated monopoly system. ***HN1*** The adoption of the Tennessee Telecommunication Act, 1995 Tenn. Pub. Acts 408 (effective June 6, 1995), abolished monopolistic control of local telephone service and opened that market to competition. It also changed the way in which providers of such services, and the rates they charge, were regulated.

HN2 As part of the implementation of local service competition, a company which was providing basic local exchange telephone service, as defined by statute, prior to June 6, 1995, was designated as the "incumbent local exchange telephone company," or ILEC. *Tenn. Code Ann. § 65-4-101(d)*. New entrants into the market after June 6, 1995, were known as "competing telecommunications service providers" or CLECs. [*3] *Tenn. Code Ann. § 65-4-101(e)*. To become a CLEC, a provider is required to be certificated pursuant to *Tenn. Code Ann. § 65-4-201*, which provides in pertinent part:

HN3 After notice to the incumbent local exchange telephone company and other interested parties and following a hearing, the authority shall grant a certificate of convenience and necessity to a competing telecommunications service provider if after examining the evidence presented, the authority finds:

(1) The applicant has demonstrated that it will adhere to all applicable authority policies, rules and orders; and

(2) The applicant possesses sufficient managerial, financial and technical abilities to provide the applied for services.

Tenn. Code Ann. § 65-4-201(c).

BellSouth BSE, Inc. applied for a certificate as a CLEC (First Application) to provide local telephone services on a statewide basis. BellSouth BSE, Inc. is a wholly owned subsidiary of BellSouth BSE Corporation which, in turn, is a wholly owned subsidiary of BellSouth Corporation. BellSouth Telecommunications ("BST"), another wholly-owned subsidiary of BellSouth Corporation, [*4] is the incumbent local exchange provider for portions of Tennessee. The Tennessee Regulatory Authority ("TRA") granted BellSouth BSE, Inc. ("BSE") authority to provide local services only in those territories where its affiliate, BST, was not the ILEC. The TRA concluded that the potential for anticompetitive harm outweighed the benefits to consumers if BSE were permitted to operate as a CLEC in those areas where its affiliate was providing local service as the ILEC.

BSE, however, was invited to re-open the issue if at any time in the future it believed it could "carry the public interest burden herein raised and alleviate the Agency's concerns with regard to Tenn. Code Ann. § 65-5-208(c). . . ." BellSouth BSE, Inc. did just that and sought expanded authority to operate as a CLEC (Second Application). Competitors were allowed to intervene, [1] and a hearing was held. The TRA denied the petition. It is that denial which is the subject of this appeal.

[*5] BSE did not propose to offer any services that could not be offered by BST. BSE intended to provide "any and all services that are or may be provided by a local exchange carrier."

I. The TRA's Concerns

In denying BSE's application for a certificate of convenience and necessity to provide expanded intrastate telecommunications services, the TRA recounted that the Second Application proceedings were held to provide BSE the opportunity to alleviate the concerns which led to the TRA's order on the First Application. Those concerns are related to the potential for anticompetitive behavior and the potential for BST to avoid controls imposed upon it because of its status as an ILEC, as well as its status under federal law as a "Bell operating company," through the use of an affiliate. The TRA expressed several specific areas of concern, which can only be examined in the context of the regulatory framework, both state and federal, for telecommunication services providers.

HN4 By enactment of the Telecommunications Act of 1996, Congress made fundamental changes in local telephone markets by, among other things, prohibiting states from enforcing laws that impede competition. In order to [*6] facilitate the transition from regulated monopolies to true competition, the Act imposes upon the incumbent provider or ILEC, who formerly enjoyed the monopoly, a number of duties intended to facilitate entry into the market by other, formerly excluded, providers. *AT & T Corp. v. Iowa Utils. Bd., 525 U.S. 366, 371-72, 119 S. Ct. 721, 726-27, 142 L. Ed. 2d 834 (1999)*. As more specifically explained:

Until the passage of the 1996 Act, state utility commissions continued to regulate local telephone service as a natural monopoly. Commissions typically granted a single company, called a local exchange carrier (LEC), an exclusive franchise to provide telephone service in a designated area. Under this protection the LEC built a local network - made up of elements such as loops (wires), switches, and transmission facilities - that connects telephones in the local calling area to each other and to long distance carriers.

HN5 The 1996 Act brought sweeping changes. It ended the monopolies that incumbent LECs held over local telephone service by preempting state laws that had protected the LECs from competition. *See 47 U.S.C. § 253*. Congress recognized, [*7] however, that removing the legal barriers to entry would not be enough, given current technology, to make local telephone markets competitive. In other words, it is economically impractical to duplicate the incumbent LEC's local network infrastructure. To get around this problem, the Act allows potential competitors, called competing local exchange carriers (CLECs), to enter the local telephone market by using the incumbent LEC's network or services in three ways. First, a CLEC may build its own network and "interconnect" with the network of an

[1] The intervenors who are also appellees in this appeal are MCI WorldCom, Inc., Southeastern Competitive Carriers Association, Time Warner Telecom of the Mid-South, L.P., and US LEC of Tennessee, Inc.

incumbent. *See id.* § 251(c)(2). Second, a CLEC may lease elements (loops, switches, etc.) of an incumbent LEC's network "on an unbundled basis." *See id.* § 251(c)(3). Third, a CLEC may buy an incumbent LEC's retail services "at wholesale rates" and then resell those services to customers under its (the CLEC's) brand. *See id.* § 251(c)(4).

GTE South, Inc. v. Morrison, 199 F.3d 733, 737 (4th Cir. 1999).

HN6 This access is accomplished through an interconnection agreement between the ILEC and a CLEC. In addition, an ILEC is required to provide access to its network elements and various services and to provide dialing [*8] parity to competing providers on a nondiscriminatory basis. *47 U.S.C. §§ 251(c)(3)* & *251(b)(3)*. The FCC has promulgated rules and policies implementing those provisions "to require incumbent LECs to provide competition with access to the incumbent LECs' networks sufficient to create a competitively neutral playing field for new entrants. . . ." *In Re Implementation of the Telecommunications Act of 1996, Third Report and Order* in CC Docket No. 96-115, *Second Order on Reconsideration of the Second Report and Order* in CC Docket No. 96-98, and *Notice of Proposed Rulemaking* in CC Docket No. 99-273, at P 6 (rel. Sept. 9, 1999).

HN7 Under state law, all providers are required to provide non-discriminatory interconnection to their public networks under reasonable terms and conditions, and all are to be provided "desired features, functions and services promptly, and on an unbundled and non-discriminatory basis from all other telecommunications providers." *Tenn. Code Ann. § 65-4-124(a)*.

HN8 At the state level, incumbent providers are also governed by specific provisions, again designed to facilitate entry into the local telephone service [*9] market by competitors. For example, rates to be charged by incumbent providers opting to be under a price regulation plan are subject to a requirement that such rates be just and reasonable, defined as "affordable", as determined by the TRA. Tenn Code Ann. § 65-5-209(a). These rates are subject to limitations, including safeguards to ensure universal service and nondiscrimination among customers. Tenn. Code Ann. § 65-5-209(b).

HN9 After the initial qualification of a price regulation plan, an ILEC's ability to increase rates is subject to limitations. Essentially, a price regulated ILEC can adjust rates for specific services subject to an overall maximum annual adjustment to aggregate revenues for such services. Tenn. Code Ann. § 65-5-209(e). However, rates for basic services cannot be increased for four (4) years after implementation of the plan, and annual increases for basic services are thereafter limited to annual rates of inflation. Tenn. Code Ann. § 65-5-209(f).

HN10 ILECs not under a price regulation plan are subject to traditional rate regulation. ILECs have unique, carrier-of-last-resort [*10] obligations and universal service obligations. Tenn. Code Ann. § 65-5-207(c)(2) & (8). ILECs, upon request, are required to provide interconnection services to CLECs. Tenn. Code Ann. § 65-5-209(d). None of these burdens apply to CLECs.

Another requirement for ILECs which was the subject of argument herein and part of the TRA's reasoning is that found in Tenn. Code Ann. § 65-5-208(c), which provides:

HN11 Effective January 1, 1996, an incumbent local exchange telephone company shall adhere to a price floor for its competitive services subject to such determination as the authority shall make pursuant to § 65-5-207. [2] The price floor shall equal the incumbent local exchange telephone company's tariffed rates for essential elements utilized by competing telecommunications service providers plus the total long-run incremental cost of the competitive elements of the service. When shown to be in the public interest, the authority shall exempt a service or group of services provided by an incumbent local exchange telephone company from the requirement of the price floor. **The authority shall, as appropriate,** [*11] **also adopt other rules or issue orders to prohibit cross-subsidization, preferences to competitive services or affiliated entities, predatory pricing, price squeezing, price discrimination, tying arrangements or other anti-competitive practices.**

(emphasis added).

It is the highlighted language which provides the primary basis for the TRA's denial of BSE's application for CLEC status in those areas where its affiliate is the incumbent provider. The TRA expressed concerns that the relationship between BSE and BST fostered the potential for the enumerated, or other, anticompetitive activities, as well as the opportunity for BST to avoid the limitations placed on [*12] it as an ILEC. The six concerns, or issues for resolution, expressed by the TRA were:

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[2] ***HN12*** Tenn. Code Ann. § 65-5-207 authorizes the TRA to establish policies, rules, and orders requiring all telecommunications service providers to contribute to the support of universal service, which consists of residential basic local exchange telephone service at affordable rates and carrier-of-last-resort obligations.

1. Whether there exists the potential for discriminatory treatment of other CLECs or for preferential treatment of BSE by BellSouth when there are no safeguards being offered to monitor affiliate transactions or performance;

2. Whether BellSouth seeks to avoid its ILEC obligations through BSE's ability to select BellSouth's best customers and offer special deals that BellSouth cannot offer due to statutory prohibitions;

3. Whether there exists the potential for the prohibited acts of price squeezing and cross-subsidization;

4. Whether in the solicitation of BellSouth business customers by BSE, those customers will continue to be offered the same services under the same utility's name, with the same personnel over the same local network as employed by BellSouth;

5. Whether BSE presented substantial and material evidence that it would provide services to consumers that could not be offered by BellSouth; and

6. Whether it is in the public interest for a Regional Bell Operating Company ("RBOC") such as BellSouth, to have an affiliated CLEC operating within its territory.

The last issue involves [*13] BellSouth's status as a RBOC, and that issue again requires some background explanation. In 1974, the U.S. Department of Justice brought an antitrust action against AT&T for monopolization of telecommunications services and equipment. *United States v. American Tel. and Tel. Co.*, 552 F. Supp. 131 (D.D.C. 1982), *aff'd sub nom. Maryland v. United States, 460 U.S. 1001, 103 S. Ct. 1240, 75 L. Ed. 2d 472 (1983)*. That long and complex litigation resulted in a settlement reflected in a consent decree. This consent decree required AT&T to divest itself of the twenty or so Bell operating companies ("BOCs") that provided local telephone service as monopolies. Under the court-approved plan, these BOCs were spun off from AT&T and grouped into seven regional holding companies, or RBOCs, who continued to provide local service as regulated monopolies until the 1996 Telecommunications Act and/or similar legislation in various states. *See AT&T Corp. v. Federal Communications Comm'n, 343 U.S. App. D.C. 23, 220 F.3d 607, 611 (D.C. Cir. 2000)*. Bell South is a RBOC. *Id.*; *see also* 47 U.S.C. § 153(4) (defining "Bell operating company" by listing [*14] twenty companies by name, including South Central Bell Telephone Company, the predecessor of BST). Although the Bell operating companies were allowed to retain their state-regulated monopolies on local service, they were prohibited by the consent decree from entering other parts of the telecommunications business, including long distance, equipment sales, and specified other services. *United States v. American Tel. and Tel. Co.*, 552 F. Supp. at 224.

The Telecommunications Act of 1996 rescinded the consent decree. While a number of key provisions apply to all incumbent local exchange carriers, such as the requirement that they offer nondiscriminatory access and interconnection to local competitors, *47 U.S.C. § 251*, the Act also includes "Special Provisions Concerning Bell Operating Companies," *47 U.S.C. §§ 271* to -276, which apply only to the BOCs and their affiliates. Some of these provisions allow BOCs to enter into formerly prohibited areas of the telecommunications market, but only under specifically enumerated conditions. Of primary importance, *§ 271* establishes requirements that a BOC or its affiliate must meet before [*15] it can provide long distance, or InterLATA, services. Those requirements relate primarily to interconnection and include a competitive checklist insuring, among other things, nondiscriminatory access to network elements and other facilities and services. *47 U.S.C. § 271(c)*. [3]

BOCs and their affiliates are barred from manufacturing and selling equipment until they have received authorization to provide interLATA services, which, of course, requires demonstrated compliance with the nondiscriminatory [*16] access requirements and the competitive checklist. *47 U.S.C. § 273*. That section includes additional strictures on such manufacturing activities. Section 276 includes nondiscrimination safeguards for provision of payphone services by a BOC and a requirement that a BOC may not subsidize its payphone services directly or indirectly from its telephone exchange service operations. In addition, BOCs may provide electronic publishing only through a separate affiliate or through a joint venture operated

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[3] The Act further provides that the FCC cannot approve a BOC or BOC affiliate application to provide interLATA services unless it finds that the applicant has met the requirements with respect to access and interconnection, has fully implemented the competitive checklist, "the requested authorization will be carried out in accordance with the requirements of section 272," and the approval is consistent with the public interest, convenience and necessity. 47 U.S.C. § 271(d)(3).

according to specific requirements, including structural separation. 47 U.S.C. § 274. [4]

Most relevant to our analysis of the issues herein, because of the parties' references to and arguments about [*17] "Section 272 affiliates" is the requirement of 47 U.S.C. § 272, which the FCC has described as follows:

HN13 Section 272(a) provides that a BOC (including any affiliate) that is a LEC subject to the requirements of section 251(c) may provide certain services only through a separate affiliate. Under section 272, BOCs (or BOC affiliates) may engage in the following activities only through one or more affiliates that are separate from the incumbent LEC entity: (A) manufacturing activities; (B) interLATA telecommunications services that originate in-region; and (C) interLATA information services.

In the Matter of Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, As Amended, CC Docket No. 96-149, First Report and Order, at P 50 (rel. Dec. 24, 1996) (footnotes omitted).

The statute establishes "structural and transactional requirements" for § 272 separate affiliates, including independent operation, maintenance of separate books and records, totally separate officers, directors and employees, and no credit arrangement whereby recourse may be had against the assets of the BOC. 47 U.S.C. § 272 [*18] (b)(1) - (4). In addition, the affiliate is required "to conduct all transactions with the Bell operating company of which it is an affiliate on an arm's length basis with any such transactions reduced to writing and available for public inspection." 47 U.S.C. § 272(b)(5). Nondiscrimination safeguards also exist. 47 U.S.C. § 272(c).

It is this structural and operational separation between the BOC and its affiliate which has been determined on the federal level to provide protection against anticompetitive practices. It allows a BOC affiliate to provide some services that the BOC itself would be prohibited from providing. This separation is a critical element in understanding the TRA's position herein.

II. ILEC Affiliation

The TRA has previously granted certificates to over thirty competing local exchange carriers to provide local services on a statewide basis. In addition, the TRA has granted certificates as CLECs to two affiliates of ILECs, namely Citizens Telecommunications Company of Tennessee and United Telephones-Southeast, Inc. [5] BSE asserts that these prior approvals establish precedent which the TRA must follow and require [*19] that BSE's statewide application be granted because the TRA is required by federal and state law to certificate CLECs on a competitively neutral basis.

[*20] The TRA responds that its prior decisions, involving other companies in other situations, do not bind it in this situation. It also asserts, and found, that BellSouth and its affiliate BST or BellSouth are different from other CLECs and their affiliates and present unique issues. The TRA found:

In Tennessee, Citizens, Sprint, and their affiliated companies are not similarly situated to BellSouth and BSE. Neither Citizens nor Sprint are RBOCs, and neither possesses the historical market dominance so closely associated with RBOCs such as BellSouth. Unlike Citizens and Sprint, BellSouth maintains approximately eighty percent (80%) of the access lines in Tennessee. Therefore, since BSE is the affiliate of the dominant local exchange carrier in Tennessee, the actions which BSE seeks to take must be evaluated by assessing whether such actions will truly foster competition in Tennessee. The authority finds that Citizens and Sprint are not similarly situated to BSE and BellSouth.

(footnotes omitted).

If the TRA had determined that BSE was ineligible to be certified statewide as a CLEC on the basis that an affiliate was disqualified from certification in the same market where its affiliate [*21] was the incumbent provider, the two

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[4] This required structural separation, or line-of-business restriction, has been upheld in a bill of attainder and first amendment challenge. BellSouth Corp. v. F.C.C., 330 U.S. App. D.C. 109, 144 F.3d 58, 61 (D.C. Cir. 1998), *cert. denied*, Apr. 26, 1999.

[5] At BSE's request, at the hearing involved herein the TRA took judicial notice of its grant of these certificates, and the records from those proceedings have been included in the record herein. Those records reflect that the TRA granted to Sprint Communications Company, L.P. a certificate to provide intrastate service based upon an application to provide a full array of telecommunications services normally provided by an incumbent local exchange telephone company throughout the State of Tennessee in all geographic locations permitted under Tenn. Code Ann. § 65-4-201. Similarly, Citizens Telecommunications Company filed an application for certification as a CLEC seeking authority to operate statewide to provide a full array of telecommunications services as would normally be provided by an incumbent local exchange telephone company. The TRA granted the application.

prior approvals would pose serious problems to affirming the TRA's order herein. However, the TRA did not find that such a *per se* disqualification existed, and we can find none in the statute. The prior approvals indicate that the TRA interpreted the Telecommunications Act as authorizing affiliates of ILECs to be certified as CLECs statewide, including in those markets where the affiliate was the incumbent.

The prior approvals also serve to rebut an argument made herein by the intervenors. Those intervenors argue that it is illegal under Tennessee law for BellSouth to operate as both an ILEC and a CLEC in the same service territory. They assert that because the Telecommunications Act defines a CLEC as a carrier providing service before June 6, 1995, and defines an ILEC as a provider of services certified after June 6, 1995, an ILEC cannot be a CLEC. We do not disagree that the statute envisions an ILEC and a CLEC as being different entities.

However, the intervenors argue that because BST cannot be a CLEC, BellSouth should not be allowed to accomplish the same illegal result through use of an affiliate; i.e., BST cannot do indirectly what it [*22] is prohibited from doing directly. While much of the intervenors' argument is addressed to BellSouth's market dominance and position, their argument is also based upon the statutory distinctions between ILECs and CLECs. To that extent, the intervenors' assertions that BellSouth cannot operate both an ILEC and a CLEC would apply equally to any other affiliate relationship. Obviously, the TRA has rejected that interpretation of the statute by certifying as CLECs at least two other entities affiliated with ILECs. We find no basis for rejecting the TRA's interpretation. In fact, the legislature apparently foresaw the possibility of an ILEC providing services to an "affiliated entity." *See* Tenn. Code Ann. § 65-5-208(c).

As the TRA's order makes clear, its denial of BSE's request for a certificate for statewide CLEC status was not based upon BSE's status as an affiliate of an ILEC *per se*. Instead, it was related to the unique position enjoyed by BellSouth as the dominant provider of local exchange services and as a Bell operating company.

We agree with the TRA that each application must be considered on its own merits and upon the facts of each individual [*23] situation. In the instant situation, the facts raise issues as to the effect of certification on competition which may differ from those raised by other incumbent affiliate applications. However, ***HN14*** the TRA cannot apply legal requirements arbitrarily or capriciously and must have a factual basis for its actions. *Tenn. Code Ann. § 4-5-322(h)*.

III. BOC Status

As set out earlier, BellSouth, BST and BSE (as an affiliate of a BOC) are subject to specific provisions of the Telecommunications Act of 1996 not applicable to other CLECs. The question is whether that status justifies a differing approach or standard for BSE's qualification as a CLEC than that applied to affiliates of other ILECs who are not also BOCs.

BSE argues that the FCC has recognized or authorized affiliates of ILECs and BOCs. The TRA has acknowledged and referred to the FCC's rulings on specific arrangements, but has distinguished the situation covered by those rulings from the situation presented by BSE's application herein.

The FCC has considered the question of the provision of local exchange and exchange access by *Section 272* BOC affiliates and reached the following conclusion:

Based [*24] on our analysis of the record and the applicable statutory provisions, ***HN15*** we conclude that *section 272* does not prohibit a *section 272* affiliate from providing local exchange services **in addition to** interLATA services, nor can such a prohibition be read into this section. Specifically, *section 272(a)(1)* states that - -

A Bell operating company (including any affiliate) which is a local exchange carrier that is subject to the requirements of *section 251(c)* may not provide any service described in *[section 272(a)(2)]* unless it provides that service through one or more affiliates that . . . are separate from any operating company entity that is subject to the requirements from *section 251(c)* . . .

We find that the statutory language is clear on its face - - a BOC *section 272* affiliate is not precluded under *section 272* from providing local exchange service, **provided that the affiliate does not qualify as an incumbent LEC subject to the requirements of** *section 251(c)*.

In the Matter of Implementation of the Non-Accounting Safeguards of Sections 271 and *272* of the Communications Act of 1934, As Amended, CC Docket No. 96-149, First Report and Order, at P 312 (rel. Dec. 24, 1996) [*25] (emphasis added).

It is clear that the FCC's comments are addressed to those BOC affiliates which are *Section 272* affiliates and are operated independently from an ILEC affiliate. They apply

where the BOC incumbent has been authorized to provide long distance services. This means that the BOC incumbent has demonstrated to the FCC's satisfaction that it has complied with the various competition requirements set out in *47 U.S.C. § 271*.

We agree with the TRA that the FCC rulings relied upon by BSE do not directly apply to an application by an affiliate of a BOC which is not a *Section 272* affiliate to provide local service in an area where the BOC is the incumbent. While BSE is not incorrect in asserting that these FCC rulings do not prohibit the grant of its application, they also do not require it. The FCC, based on federal statutory law, has found that BOC affiliates may provide certain kinds of services when circumstances not present in the case before us exist.

BSE is not a *Section 272* affiliate, and does not claim to be. *Section 272* affiliate status only applies to affiliates of a BOC which have received *Section 271* approval. The TRA determined that BSE [*26] "remains a type of affiliate not contemplated under § 272." In addition, the TRA explained:

It is appropriate that BSE has not requested in its Application to provide non-incidental services, because BSE cannot satisfy the requirements for a *Section 272* affiliate, for those services, until interLATA permission is granted pursuant to *Section 271*. The Authority concludes that BSE cannot, at this time, as a matter of law, provide *Section 272(a)(2)* non-incidental services, does not intend to provide *Section 272(a)(2)* incidental services, and is, therefore, not a *Section 272* affiliate. Having concluded as such it is difficult to embrace the position that the safeguards established under *Section 272* are applicable to BSE. It is equally difficult to accept that an entity such as BSE is of the type contemplated by the FCC's pronouncement that *Section 272* does not prohibit a *Section 272* affiliate from providing local exchange services in addition to interLATA services.

(footnotes omitted).

The TRA asserts that BSE's lack of *Section 272* status is important is considering the competitive goals of both federal and state legislation. The Authority contends that *Section 271* approval indicates [*27] satisfaction of the requirements for entry into the long distance market, including compliance with the competitive checklist. As of the date of the proceedings herein, BellSouth did not have *Section 271* approval, and the TRA states that BellSouth has been denied that approval several times by the FCC and in other states. [6] Consequently, the TRA found that BSE had not been required to show that it has adequate operations support systems with performance measurements in place which would "provide assurance that the public welfare is protected by ensuring that competing carriers have a means to compete and are treated in a competitively neutral manner by the ILEC [BST]." The TRA also found that not only does the denial of such approval indicate that the required proof of compliance with competitive safeguards was not provided in those proceedings, the TRA found that BSE did not demonstrate such compliance in the hearing herein.

[*28] The TRA did not deny the application for statewide CLEC certification because of BSE's status as a BOC or BOC affiliate. It did, however, consider that status as a factor in its consideration of the competitive effect of allowing BSE to compete with its affiliate where the competition protections assured by *Section 272* affiliate status are not present. We conclude that neither BSE's status as an ILEC affiliate nor its status as a BOC affiliate was the basis for the TRA's denial. That status did, however, influence the standards applied by the TRA to BSE in its consideration of the competitive effect of granting BSE's application.

IV. The Issues Presented and The Standard of Review

As the list of TRA concerns set out earlier in this opinion demonstrates, the TRA focused its decision on the potential

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[6] For example:

In the Matter of Application of BellSouth Corporation, et al., Pursuant to Section 271 of the Communications Act of 1934, as amended, to Provide In-Region, InterLATA Services in *South Carolina*, 13 FCC Rcd 539, 547 P 14 (1997) (failure to (1) provide nondiscriminatory access to operations support systems, (2) provide unbundled network elements in a manner that permits competing carriers to combine them through collocation, and (3) offer certain retail services at discounted rates), *aff'd*, *BellSouth Corp. v. FCC*, 333 U.S. App. D.C. 253, 162 F.3d 678 (D.C. Cir. 1998); *In the Matter of Application by BellSouth Corporation, et al., Pursuant to Section 271 of the Communications Act of 1934, as amended, to Provide In-Region, InterLATA Services in Louisiana*, 13 FCC Rcd 6245, 6246-47 P 1 (1998) (failure to provide nondiscriminatory access to operations support system and to make telecommunications services available for resale); *In the Matter of Application of BellSouth Corporation, BellSouth Telecommunications, Inc., and BellSouth Long Distance, Inc., for Provision of In-Region, InterLATA Services in Louisiana*, 13 FCC Rcd 20599, 20605 P 10 (1998) (failure to provide nondiscriminatory access to operations support system and unbundled network elements).

AT&T Corp. v. FCC, 220 F.3d at 613.

for anticompetitive activities and conduct if an affiliate of the Regional Bell Operating Company and ILEC were certified as a CLEC, especially in the absence of the protections provided by federal law to *Section 272* affiliates. In the order now under appeal, the TRA noted that in its previous denial "one critical area of concern was that the affiliate relationship between BST [*29] and BSE could be potentially and irreversibly adverse to competition." The TRA found without *Section 271* approval of BellSouth, there was still no evidence that BellSouth had the necessary safeguards in place to ensure fair treatment among all CLECs and further stated:

Exacerbating our concern is that no other performance measurements have been established, which arguably help to serve as support to the existence of competitive neutrality in the relationship between BellSouth, BSE and other CLECs. Without these safeguards and measurements the Authority would have difficulty determining whether BellSouth in fact afforded preferential treatment to its affiliate CLEC in Tennessee.

It was on the basis of these concerns that the TRA determined that approval of BSE's application was not in the public interest and "may, in fact" be inconsistent with the goal of competition. The TRA concluded that BSE offered little convincing evidence or testimony to diminish its concerns regarding potentially abusive collusive behavior.

On appeal, our review of the TRA's order is governed by *Tenn. Code Ann. § 4-5-322(h)*, which provides:

HN16 The court may affirm the decision of [*30] 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) Unsupported by evidence which is both substantial and material in the light of the entire record.

HN17 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.

HN18 The TRA may exercise only that authority given it expressly by statute or arising by necessary implication from an express grant. *BellSouth Adver. & Publ'g Corp. v. Tennessee Regulatory Auth., 79 S.W.3d 506, 512 (Tenn. 2002)*; *Tennessee Pub. Serv. Comm'n v. Southern Ry. Co., 554 S.W.2d 612, 613 (Tenn. 1977)*. [*31] The General Assembly has given the TRA "practically plenary authority over the utilities within its jurisdiction." *BellSouth Adver. & Publ'g Corp., 79 S.W.3d at 512* (quoting *Tennessee Cable Television Ass'n v. Tennessee Pub. Serv. Comm'n*, 844 S.W.2d 151, 159 (Tenn. Ct. App. 1992)). The TRA has "general supervisory and regulatory power, jurisdiction, and control over all public utilities." *Tenn. Code Ann. § 65-4-104*. The General Assembly has given the TRA, in addition to other jurisdiction conferred, the authority to "investigate, hear and enter appropriate orders to resolve all contested issues of fact or law arising as a result of the application of Acts 1995, ch. 408 [the Tennessee Telecommunications Act]." Tenn. Code Ann. § 65-5-210(a).

BSE asserts, however, that the TRA's order was contrary to governing statutory provisions. In reviewing BSE's request, the TRA was required to apply *Tenn. Code Ann. § 65-4-201(c)*, quoted earlier, which establishes the requirements for certification as a competing provider. BSE asserts that it met the two requirements by demonstrating: [*32] (1) that it will adhere to all applicable TRA policies, rules and orders; and (2) that it possesses managerial, financial and technical abilities to provide the services. BSE cites the TRA's approval of it as a CLEC in some territories in Tennessee as proof the TRA has found that BSE meets these statutory qualifications. Accordingly, BSE argues, the TRA was required to grant its application for statewide certification because of the mandatory language of the statute.

There is no dispute that BSE met the two requirements of *Tenn. Code Ann. § 65-4-201(c)*. The TRA, however, determined that its other statutorily assigned responsibilities required it to examine the application in light of its effect on competition, including its responsibility under *Tenn. Code Ann. § 65-4-201(a)* to consider the present and future public interest in determining whether to grant a certificate of convenience and necessity. In the case herein, however, the TRA defined that public interest in terms of the impact of BSE's application on competition. It is clear from the order that the TRA's reason for denying BSE certification as a CLEC in those areas [*33] where its affiliate was the ILEC was its determination that such certification could adversely

impact the development of competition in the provision of local telephone service.

The TRA maintains that it was required to consider the effect on competition. The TRA relied upon its obligations set out in Tenn. Code Ann. § 65-5-208(c), also quoted above, to prohibit anticompetitive practices in dealings between the incumbent and competitors. The TRA was also mindful of the General Assembly's policy of fostering competition, as set out in the Tennessee Telecommunications Act of 1995:

HN19 The general assembly declares that the policy of this state is to foster the development of an efficient, technologically advanced, statewide system of telecommunications services by permitting competition in all telecommunications services markets, and by permitting alternative forms of regulation for telecommunications services and telecommunications services providers. To that end, the regulation of telecommunications services and telecommunications services providers shall protect the interests of consumers without unreasonable prejudice or disadvantage to any telecommunications [*34] services provider; universal service shall be maintained; and rates charged to residential customers for essential telecommunications services shall remain affordable.

Tenn. Code Ann. § 65-4-123. ***HN20*** In the preamble to the Tennessee Telecommunications Act, the General Assembly stated a policy that "Competition among providers should be made fair by requiring that all regulation be applied impartially and without discrimination to each." 1995 Tenn. Pub. Acts ch. 408.

In addition, ***HN21*** federal law places a duty on the TRA to promote or insure competition in the provision of telecommunication services. In particular, the Telecommunications Act of 1996 requires removal of barriers to entry into that business and states:

HN22 (a) In general. No State or local statute or regulation, or other State or local legal requirement, may prohibit or have the effect of prohibiting the ability of any entity to provide any interstate or intrastate telecommunications service.

(b) State regulatory authority. Nothing in this section shall affect the ability of a State to impose, on a competitively neutral basis and consistent with Section 254 of this title, requirements necessary [*35] to preserve and advance universal service, protect the public safety and welfare, ensure the continued quality of telecommunications services, and safeguard the rights of consumers.

47 U.S.C. § 253.

We agree with the TRA that it has the authority to consider the effect on competition of an application for statewide certification as a CLEC. In addition to its general almost plenary authority to regulate public utilities and the authority granted by the statutes quoted herein, it also has specific authority to adopt rules or issue orders to prohibit anticompetitive practices. Tenn. Code Ann. § 65-5-208(c). Thus, we conclude the TRA did not act in excess or in contravention of relevant statutory authority in considering the effect on competition.

However, the authority to consider the effect on competition does not remove the requirements that the agency base its decisions on substantial and material evidence and that those decisions not be arbitrary or capricious. The determinative issues in this appeal are framed by BSE's arguments that the TRA's decision was arbitrary because it differentiated among ILEC affiliates and that [*36] the decision was based upon speculation and not upon the evidence and, therefore, is not supported by substantial and material evidence. In addition, BSE asserts that the TRA's order is actually anticompetitive and prevents BSE's entry into the market as a competing local exchange service provider by establishing more stringent requirements for it than those applied to other ILEC affiliates. The intervenors assert that BST is already dominant in the local services market, making removal of barriers to entry irrelevant. The TRA asserts its order was designed to further the competition envisioned by both federal and state law.

The TRA did, in fact, treat BSE's application differently from applications for statewide CLEC certification other affiliates of ILECs. They based this differing treatment on BSE's relationship to BellSouth, which has undisputed market dominance in the state and which is a BOC. Regional Bell Operating Companies have been subject to strictures and limitations not applicable to other companies since the consent order was entered in *United States v. American Tel. and Tel. Co.* ***HN23*** The 1996 Telecommunications Act has special provisions relating to RBOCs. Because RBOCs [*37] had gained control of the local services markets through a monopoly, such measures were considered necessary if true competition were to develop as a practical matter.

HN24 The FCC has recognized the authority of state regulatory agencies to treat certain BOC related entities differently because of the potential impact on competition.

State regulation. As mentioned above, several BOCs have already submitted applications to state regulatory

commissions seeking authority to provide both local exchange services and interLATA services from the same affiliate. Although we conclude that the 1996 Act permits section 272 affiliates to offer local exchange service in addition to interLATA service, we recognize that individual states may regulate such integrated affiliates differently than other carriers. [7]

[*38] *In the Matter of Implementation of the Non-Accounting Safeguards of Sections 271* and *272* of the Communications Act of 1934, As Amended, CC Docket No. 96-149, First Report and Order, at P 317 (rel. Dec. 24, 1996) (footnotes omitted).

Although state statues do not make reference to RBOCs, we conclude that the TRA had the authority to consider BellSouth's market dominance in the state and its status as a BOC in analyzing the competitive effects of its affiliate's application. We also conclude that Tenn. Code Ann. § 65-5-208(c) gave the TRA the authority to issue orders which would prohibit the specific anticompetitive practices listed in the statute, as well as others. Because the relationship between BST, BSE, and BellSouth provides a situation where such practices can develop, the TRA was authorized to examine this situation differently from other applications and to adopt rules or to establish by order standards or requirements to fulfill its responsibility to further competition.

However, that is not what the TRA did. Instead of "regulating" a BOC affiliate differently, the TRA denied the certification. BSE describes the TRA's decision as "Rather [*39] than engage with BSE in a reasonable framework of regulation for its services in the market, the TRA has chosen to simply deny BSE a place at the table." The question is whether the TRA could deny certification under the facts presented.

V.

The TRA had previously expressed its concerns about the potential for anticompetitive conduct between BSE and its affiliates. The second hearing was held to allow BSE to address those concerns. In the hearing, BSE offered to submit itself to various requirements to alleviate the concerns of the TRA. In specific, BSE offered:

(1) To operate independently from BST;

(2) To maintain its books, records, and accounts separate from the books, records, and accounts maintained by BST;

(3) To have separate officers, directors, and employees from BST;

(4) Not to obtain credit under any arrangement that would permit a creditor, upon default, to have recourse to the assets of BST;

(5) To conduct all transactions with BST on an arms' length basis with any such transactions reduced to writing and available for public inspection; [8]

(6) Not to engage in cross-subsidization, granting preferences to competitive services or affiliated entities, predatory [*40] pricing, price squeezing, price discrimination, tying arrangements, or other anticompetitive practices as prohibited by Tenn. Code Ann. § 65-5-208(c);

(7) To set its price floor equal to the wholesale price it pays to BST;

(8) To file and resell its Contract Service Agreements;

(9) To be bound by the non-discrimination requirements of *47 U.S.C. §§ 251* and *252*;

(10) To file tariffs;

(11) To consent to regular audits of its operations by the TRA;

(12) To provide cost allocation data of its operations;

(13) To accept advertising restrictions assuring that any advertising would properly identify "BellSouth BSE";

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[7] BSE's application does not include a proposal to provide interLATA (long distance) services. As discussed earlier, the FCC's pronouncements have involved Section 272 affiliates who propose to provide both local and long distance services. Thus, in our earlier discussion of BOC status, we have agreed with the TRA that the FCC's recognition of BOC and ILEC affiliates is not dispositive of the question of whether an affiliate which is not a Section 272 affiliate may qualify as a CLEC where its affiliate is the ILEC. However, while the finding that state regulatory agencies may regulate integrated affiliates differently from other entities is not directly applicable to a non-272 affiliate becoming a CLEC, we think the principles involved are similar enough to warrant reliance on the FCC's recognition of state agencies' authority to regulate BOC affiliates differently.

[8] Items 1-5 replicate the structural separation requirements set out in 47 U.S.C. § 272(b).

(14) To submit to any other applicable ILEC Rules in the event BSE undertakes the activities of its ILEC affiliate BST; and

(15) To abide by any and all of the applicable TRA policies, rules and orders.

The TRA found these promises [*41] insufficient, primarily for three reasons. It determined that BSE's failure to file a cost allocation manual prevented the Authority from determining whether appropriate safeguards were in place to prevent cross-subsidies between regulated and non-regulated services. [9] Similarly, BSE did not file a business plan, and the TRA stated it routinely examined such plans when considering CLEC applications. The TRA found that "The lack of a business plan and cost allocation manual prevents the Authority from determining the extent to which BSE intends to operate, and whether such operation and the provisioning of telecommunications services on an expanded level is compatible with the public interest."

[*42] Although BSE did not file a business plan, an Intervenor introduced into evidence a report prepared for BellSouth by a consultant regarding the benefits to BellSouth of sending a CLEC affiliate into various markets. BSE disavowed the report, stating that it did not serve as BSE's business plan. In its brief, the TRA argues the report is "significant, not as a representation of BSE's current or future business practices, but for its indication of the most obvious opportunities that a CLEC affiliate would provide for BellSouth and for the fact that BellSouth was studying these opportunities in great detail." The brief continues:

The report is replete with statements that BellSouth viewed its "CLEC" as an extension of BellSouth, which would benefit from maximum identification with BellSouth, that the CLEC would be operated as part of a comprehensive business strategy that would pertain to all BellSouth companies, and that the CLEC would offer many ways of circumventing regulatory restraints on BellSouth's incumbent LEC operations. . . . Elsewhere, the report states that the rationale for establishing a CLEC is that "BellSouth needs alternatives to gain pricing and packaging freedoms. [*43] "

We do not disagree with the TRA's description of the report. Although BSE denied the report was ever its business plan, the TRA argues that "The existence of this report submitted by the Intervenors and the absence of a business plan from BSE creates a reasonable presumption that BST intended to let loose its affiliate 'CLEC' upon the market not as a truly independent competitor and in order to circumvent regulatory requirements."

The final, and apparently most significant, reason given by the TRA is its interpretation of BSE's offer to be bound by a price floor equal to the resale price it pays to BST for the purchase of its telecommunications services. As discussed above, Tenn. Code Ann. § 65-5-208(c) requires an ILEC to adhere to a price floor for its competitive services which must equal the ILEC's rates for essential services used by CLECs plus the total long-run incremental cost of the competitive elements of the service.

One of the major concerns of the intervenors was the price floor issue. On appeal, they argue that Tennessee has established a "price floor" for certain ILEC services and prohibited the ILEC from charging customers less than that [*44] amount for the purpose of preventing ILECs from engaging in predatory pricing, *i.e.*, pricing services below cost. The intervenors' expert testified that the price floor statute prevents an incumbent provider with market power from pricing services at less than cost and thereby discouraging potential competitors from building their own networks. Essentially, the intervenors argue that since an ILEC is restricted by law to a price floor, the same public policy requires that an affiliate of an ILEC be subject to the same restriction because the ILEC should not be allowed to avoid the statutory price floor by operating through an affiliate. [10]

[*45] The TRA was also unconvinced that BSE's offer regarding the price floor was sufficient to alleviate its concerns about anticompetitive conduct and found:

In an effort to lessen the anti-competitive effect of its expanded certification, BSE agreed to be bound by a price floor equal to the resale price paid to BellSouth for the

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[9] There is proof in the record that with regard to BSE's operation in the Tampa, Florida area, cost allocations between BSE and BellSouth's cellular phone company were not very strict, even though the companies shared some costs. For example, the cellular provider paid all advertising costs, and BSE did not pay a portion of that.

[10] The intervenors' position is explained in their brief as follows:

Based on the testimony at the second hearing, here is how BSE's scheme would work: Under federal law, BellSouth is required to make all services available for resale at a discounted, wholesale rate. In Tennessee, state regulators have determined that BellSouth's wholesale rate should be 16% less than the carrier's retail rate. Thus, if BellSouth's retail rate for local service were $ 12.15, a CLEC may purchase that service for a discounted price of $ 10.31.

purchase of its telecommunications services. However, BSE failed to demonstrate whether the resale price it will pay to BellSouth will or will not include operator service costs, administrative costs, or marketing and advertising costs. Absent an evidentiary demonstration of all costs to be included in the resale price paid to BST, the "price floor" promised by BSE may not be comparable to that set for incumbents under Tenn. Code Ann. § 65-5-208(c). Furthermore, the Authority is of the opinion that if a price floor is to act as a deterrent against price squeezing, the floor must be set in a manner that will ensure that all of the costs of providing the services are included therein. Thus, a meaningful promise to be bound to a price floor will not only include the rate paid to BellSouth by BSE, but will also include additional costs [*46] incurred by BSE in providing such services. Under BSE's proposal to set the price floor at the resale rate paid to BellSouth, BSE would still be free to sell a service below the total cost that BSE must incur to provide that service.

On appeal, the TRA contends that the danger of a price squeeze is presented by the possibility that BSE would lower its resale price, "as long as the cost components of that price are undisclosed or are subject to manipulation," to a level that competitors of BSE and BST would be unable to match. The TRA found BSE's promise to set its price floor at the resale rate it pays BST would still allow BSE to resell a service below the overall cost to BSE of providing the service. The TRA contends this situation results in an "obvious opportunity" for a price squeeze. *See Town of Norwood v. New England Power Co., 202 F.3d 408, 418 (1st Cir. 2000)* (explaining the "traditional price squeeze").

The TRA points out that BSE has never agreed to apply the price floor as described by the TRA. BSE argues that its price floor agreement must be considered in conjunction with the other safeguards it promised to comply with, which will "ensure that all [*47] of the costs of providing its services are included in its pricing."

The price floor statute only applies to incumbent providers and does not by its terms apply to CLECs. In fact, in situations where an affiliate relationship with the incumbent is not present, the issue would simply not arise. Consequently, the TRA must rely upon its authority to promote competition and prevent anticompetitive practices as authority for its decision. There is no evidence in the record that in the other situations where the TRA has approved an affiliate of the incumbent provider as a CLEC that any such price floor requirement has been imposed.

It is the relationship between BSE and BellSouth and BellSouth's market dominance and status as a RBOC that created the "concerns" that led the TRA to determine that anticompetitive practices might occur. It is actually the potential for BellSouth to use a subsidiary to circumvent restrictions placed on its operation by federal and state law and regulation, to the detriment of competition, which is at the core of the TRA's action. The fact that it is the affiliate relationship that is the problem is exemplified in the TRA's finding that, "Counterbalancing [*48] these proposals [BSE's agreement to the listed restrictions] in the record before the TRA are BSE's numerous demonstrations of its close ties to BST. Further, as BSE's witness admitted, BSE and BST will remain affiliates. BSE will be nominally independent of BST, but neither will be truly independent of BellSouth Corporation." [11] Although the TRA did not decide that no affiliate of BellSouth or BST could be certified as a CLEC in those areas where BST is the incumbent provider, it did not by rule or order establish minimum requirements to insure the type of independent operation it felt necessary to prevent "possibilities" for anticompetitive conduct.

[*49] The FCC has addressed concerns similar to those raised by the TRA in the context of a *Section 272* affiliate (an affiliate of a BOC which meets the structural separation requirements of *47 U.S.C. § 272*) in its report entitled *In the Matter of Implementation of the Non-Accounting Safeguards of Sections 271* and *272* of the Communications Act of

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During cross-examination, [BSE] was asked to assume, for the sake of argument, that BellSouth's $ 12.15 rate was also the price floor for that service, as calculated in accordance with section 208(c). Under those circumstances he repeatedly maintained that BSE could legally purchase BellSouth's service at the wholesale rate and resell it for $ 10.31 or $ 10.81, substantially less than BellSouth's price floor. In an effort to persuade the TRA to approve BSE's proposal, [BSE] said BSE would agree to price its services at no less than $ 10.31 - the wholesale price it paid to BellSouth - but would not agree to abide by BellSouth's price floor of $ 12.15.

[11] The Intervenors assert that this case is simply about whether BellSouth can be both an ILEC and a CLEC at the same time and in the same service territory. "Since BSE does not propose to offer any services to Tennessee customers that BellSouth itself cannot also offer, the only apparent reason for BSE's creation is to allow BellSouth to do indirectly, through an affiliate, what it cannot do directly, i.e., to engage in otherwise prohibited pricing and marketing strategies." The intervenors assert that the BellSouth companies are attempting to avoid the effect of those statutes which prohibit BellSouth itself from obtaining a CLEC certificate and which regulate BellSouth as the incumbent provider. This argument presupposes, among other things, that there is no structural and operational separation between the affiliates.

1934, As Amended, CC Docket No. 96-149, First Report and Order (rel. Dec. 24, 1996), wherein it made the following findings:

We also conclude ***HN25*** as a matter of policy that regulations prohibiting BOC *section 272* affiliates from offering local exchange service do not serve the public interest. The goal of the 1996 Act is to encourage competition and innovation in the telecommunications market. We agree with the BOCs that the increased flexibility resulting from the ability to provide both interLATA and local services from the same entity serves the public interest, because such flexibility will encourage *section 272* affiliates to provide innovative new services. To the extent that there are concerns that the BOCs will unlawfully subsidize their affiliates or accord them preferential treatment, we reiterate that improper [*50] cost allocation and discrimination are prohibited by existing Commission rules and *sections 251*, *252*, and *272* of the 1996 Act, and that predatory pricing is prohibited by the antitrust laws. Our affiliate transaction rules, as modified by our companion Accounting Safeguards Order, address the BOCs' ability to engage in improper cost allocation. The rules in this Order and our rules, in our First Interconnection Order and our Second Interconnection Order ensure that BOCs may not favor their affiliates. In sum, we find no basis in the record for concluding that competition in the local market would be harmed if a *section 272* affiliate offers local exchange service to the public that is similar to local exchange service offered by the BOC.

Id. at P 315 (footnotes omitted).

Of course, BSE is not a *Section 272* affiliate, and the structural separation requirements established in that provision are not automatically imposed upon BSE. There is no impediment, however, to the TRA imposing the same safeguards as a condition to certification, by virtue of its authority under Tenn. Code Ann. § 65-5-208(c). [12] In fact, BSE and BellSouth agreed to be bound [*51] by those structural separation requirements. The TRA could have included other requirements directly related to preventing anticompetitive practices between BSE and BellSouth. Again, BSE and BellSouth agreed to additional safeguards, including the filing of various documents, accepting advertising restrictions which ensure the proper identification of the affiliate, providing cost allocation data, and setting its price floor equal to the wholesale price it pays to BST.

[*52] The TRA determined these offers were not sufficient. However, it did not, by order or rule, establish the minimum requirements or safeguards it thought necessary. Instead, it determined that BSE did not sufficiently allay concerns that anticompetitive practices might occur. The TRA found that approval of BSE's application "may" be inconsistent with the goal of fostering competition, that potentially abusive, collusive behavior "might" occur, and that the relationship "could be potentially" adverse to competition.

Additionally, the TRA is not bound by the FCC's judgment that competition in local markets would not be harmed, considering the safeguards provided elsewhere, if *Section 272* affiliates were to offer local service. The TRA is authorized to make its own determination about the effect of competition in this state. However, the TRA did not make a determination that competition would be adversely affected by certification of BSE statewide. It merely found that certification "may" be contrary to promotion of competition. Apparently, any harm to competition would come only if the affiliated entities acted collusively, in an anticompetitive manner, and in violation of existing prohibitions.

[*53] ***HN26*** While Tenn. Code Ann. § 65-5-208(c) authorizes the TRA to implement safeguards to prohibit anticompetitive conduct between an ILEC and its affiliated CLEC, we can find nothing in the statute to authorize the TRA to deny certification of a related entity simply because, by its nature, the affiliate relationship may provide the opportunity for anticompetitive practices. The legislature has prohibited anticompetitive conduct, not affiliation relationships. The TRA's responsibility in that situation is to put in place standards or requirements to prohibit and prevent the anticompetitive possibilities from becoming realities and/or to make violations easier to discover so that regulation is effective.

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[12] The Georgia Public Service Commission, in ruling on a similar application by BSE in Georgia, stated that:

The critical issue that is raised in this proceeding stems from the affiliate relationship the Applicant has with the predominant incumbent local exchange carrier in Georgia, BellSouth Telecommunications, Inc. Testimony presented by the intervenors raises questions as to whether the service expected to be provided by the Applicant will indeed be in competition with BST. Or, will the entry of the Applicant into the local exchange market simply garner for the parent corporation an even larger share of the market in Georgia and thereby thwart the movement toward telecommunications competition in the state.

After finding that there was not sufficient cause to deny the application, the Commission found that certain conditions would be imposed. Those included use of the same operating system support as other CLECs, a prohibition of favoring treatment to BSE by the incumbent, and certain reporting requirements.

We conclude that the TRA's decision herein must be vacated because it is in excess of the statutory authority of the agency. We remand to the TRA for consideration of BSE's application in light of the principles set out in this opinion. Because the order which is the subject of this appeal

does not establish standards, requirements, or conditions, for the certification, we do not rule upon the validity of any such requirement. [13] Costs of this appeal are [*54] taxed to the Tennessee Regulatory Authority.

PATRICIA J. COTTRELL, JUDGE

[13] For example, we decline to address the issue of whether the TRA may impose a minimum charge or price floor on BSE which insures it recoups all its costs.