

customers in the Chalet Village Subdivision in Sevier County, Tennessee.¹ On September 22, 2017, Tennessee Water filed its *Petition* seeking to recover alleged costs for providing water service to its customers in the aftermath of 2016 wildfires in East Tennessee.² Tennessee Water has not had a general rate case since Docket No 09-00017.³ In its *Petition*, Tennessee Water proposed four interim changes to its current Tariff rates and charges.⁴ The only one addressed in this brief is the “Make-Whole” Surcharge. Tennessee Water projected a “net operating loss of \$72,301 for the 2017 fiscal year.”⁵ To address this shortfall, Tennessee Water proposed the “Make-Whole” Surcharge.⁶ Since the proposed “Make-Whole” Surcharge would recover past losses for past services on future ratepayers, the approval of this surcharge would violate the prohibition on retroactive ratemaking.

II. TENNESSEE’S PROHIBITION ON RETROACTIVE RATEMAKING.

A. Overview of Ratemaking in Tennessee.

Before addressing the issue of retroactive ratemaking, it is helpful to first review TPUC’s role and authority and then review basic utility ratemaking principles. The Tennessee Supreme Court addressed TPUC’s role in the following manner:

The [TPUC] is “in the service of the public. They are representing the public at large in fixing reasonable and just rates for public service utilities to charge in intrastate rates for public service to the people of Tennessee. As such a body its duties are to a large extent administrative and may be to some extent quasijudicial but on the whole it is a legislative body because most of these things which it does, that is, fixing rates for various utilities are things that the Legislature would do through committees.”⁷

¹ *Petition* at 1, ¶2.

² *Id.* at 1.

³ *Order Approving Settlement Agreement, In Re: Petition of Tennessee Water Service, Inc. to Change and Increase Certain Rates and Charges*, TPUC Docket No. 09-000017 (September 15, 2009).

⁴ *Petition* at 1, ¶16. Tennessee Water also proposes two accounting deferral mechanisms. *Id.* at 8, ¶18-19.

⁵ *Id.* at 3, 13.

⁶ Tennessee Water’s Response to CPAD #1-26.

⁷ *S. Bell Tel. & Tel. Co v. Tenn. Pub. Serv. Comm’n*, 304 S.W.2d 640, 649 (Tenn. 1957). *See also Tenn. Cable Television v. Tenn. Pub. Serv. Comm’n*, 844 S.W.2d 151, 158-159 (Tenn. Ct. App. 1992) (citing *Blue Ridge Transp.*

Tennessee courts clearly identify ratemaking as one of the legislative functions performed by TPUC.⁸ When a public utility like Tennessee Water wants to increase its rates due to increased expenses or decreased revenue, it is required to file a petition with TPUC and to file a revision to its existing tariff requesting approval from TPUC.⁹ The petitioning utility has the burden of proof to show such an increase is just and reasonable.¹⁰ This is a “heavy burden” for the petitioning utility since there is a “presumption of validity” when TPUC fixes rates under its expert judgment.¹¹

While TPUC is directed by statute to fix just and reasonable rates, neither the legislature nor the courts have identified a “precise formula or yardstick” for TPUC to use in determining rates.¹² TPUC itself recognizes that “rate-making is an extremely complex process” which requires more than mathematical formulas and data input.¹³ Because of this complexity, TPUC and its supporting staff draw on its knowledge and expertise in the field of utility regulation in determining just and reasonable rates.¹⁴ TPUC also “balances the interests of the utilities subject to its jurisdiction with the interests of Tennessee consumers, i.e., it is obligated to fix just and reasonable rates.”¹⁵ Accordingly, “the rate approved by the TRA[sic] must provide the utility the opportunity to earn a just and reasonable return on its investment; on the other hand the rate must

Co. v. Pentecost, 343 S.W.2d 903, 904 (Tenn. 1961); *Louisville & Nashville R.R. v. Fowler*, 271 S.W.2d 188, 192 (Tenn. 1954); *GBM Commc’ns, Inc. v. United Inter-Mountain Tel. Co.*, 723 S.W.2d 109, 112 (Tenn. Ct. App. 1986).

⁸ *Tenn. Cable Television v. Tenn. Pub. Serv. Comm’n*, 844 S.W.2d 151, 158-159 (Tenn. Ct. App. 1992) (citing Tenn. Code Ann. § 65-5-201 (1982); *S. Bell Tel. & Tel. Co. v. Tenn. Pub. Serv. Comm’n*, 304 S.W.2d 640, 649 (Tenn. 1957); *McCollum v. S. Bell Tel. & Tel. Co.*, 43 S.W.2d 390, 390-91 (Tenn. 1931)).

⁹ *Tenn. American Water v. Tenn. Regulatory Auth.*, 2011 WL 334678 *1 (Tenn. Ct. App. 2011).

¹⁰ Tenn. Code Ann. § 65-5-103(a).

¹¹ *S. Bell Tel. & Tel. Co. v. Tenn. Pub. Serv. Comm’n*, 304 S.W.2d 640, 649 (Tenn. 1957). TPUC is authorized to fix just and reasonable rates pursuant to Tenn. Code Ann. § 65-5-101(a).

¹² *CF Indus. v. Tenn. Pub. Serv. Comm’n*, 599 S.W.2d 536, 538 (Tenn. 1980) (citing *Allied Chemical Corp. v. Ga. Power Co.*, 224 S.E.2d 396 (Ga. 1976)).

¹³ *Id.* at 538 (where the Court upheld the holding of the Tennessee Public Service Commission).

¹⁴ *Id.* at 543 (citing *St. Paul Area Chamber of Commerce v. Minn. Pub. Serv. Comm’n*, 251 N.W.2d 350 (Minn. 1977)).

¹⁵ *Id.* at 3-4 (November 2, 2017) (citing Tenn. Code Ann. § 65-5-201). See also *Tenn. Cable Television Ass’n v. Tenn. Publ. Serv. Comm’n*, 844 S.W.2d 151, 159 (Tenn. Ct. App. 1992) (stating rates should take into consideration the interests of both the consumer and the utility).

not be exorbitant, so as to avoid the exploitation of consumers.”¹⁶ Although no prescribed mathematical formula exists, TPUC must approve “rates that provide regulated utilities the opportunity to earn a just and reasonable return on their investments.”¹⁷ An opportunity to earn a just and reasonable return, however, is not a guarantee of one.

B. Retroactive Ratemaking and its Prohibition in Tennessee.

Underlying the ratemaking process is the fundamental rule that rates are prospective in nature, or setting rates to address the future.¹⁸ If ratemaking is prospective in nature then it is not a retroactive process, or setting rates to address the past.¹⁹ This interconnectedness of prospective ratemaking and retroactive ratemaking is explained as follows:

The rule stems from ratemaking’s legislative character: legislative activity is prospective in nature, and the legislature has delegated its ratemaking authority to the regulator. To ‘correct’ a pre-existing rate based on end of year results, the commission would have to order a change to previously approved rates, then apply that change to a past period. That is the definition of retroactive ratemaking.²⁰

The rule against retroactivity serves an important purpose. It “prevents ratemaking-by-ambush. Rates, like statutes, are prospective legislative acts. Prohibiting retroactivity aligns rates with legitimate expectations, thus satisfying the Constitution and making policies predictable.”²¹ A principle supporting the prohibition of retroactive ratemaking is “that those customers who use power should pay for its production rather than requiring future ratepayers to pay for past use.”²²

¹⁶ *Consumer Advocate & Prot. Div. v. Tenn. Regulatory Auth.*, 2012 WL 1964593 *1 (citing *Bluefield Water Works & Improvement Co. v. Publ. Serv. Comm’n of the State of W. Va.*, 262 U.S. 679, 690 (U.S. 1923)).

¹⁷ *Final Order Denying Petition, In Re: Petition of Tennessee Wastewater Systems, Inc. for Approval of Adjustments of Its Rates and New Tariff*, TPUC Docket No. 16-00139, pgs. 3-4 (November 2, 2017) (citing Tenn. Code Ann. § 65-5-201).

¹⁸ See, e.g., *American Ass’n of Retired Persons v. Tenn. Pub. Serv. Comm’n*, 896 S.W.2d 127, 133-34 (Tn. Ct. App. 1994); *S. Cent. Bell v. Tenn. Pub. Serv. Comm’n*, 675 S.W.2d 718, 719 (Tenn. Ct. App. 1984); *Porter v. S.C. Pub. Serv. Comm’n*, 493 S.E.2d 92, 97 (S.C. 1997); *Popowski v. Pa. Pub. Util. Comm’n*, 642 A.2d 648, 650 (Pa. Commw. Ct. 1994); *S.C. Elec. & Gas Co. v. Pub. Serv. Comm’n*, 272 S.E.2d 793, 795 (S.C. 1980).

¹⁹ *Id.*

²⁰ SCOTT HEMPLING, *REGULATING PUBLIC UTILITY PERFORMANCE: THE LAW OF MARKET STRUCTURE, PRICING AND JURISDICTION* 326 (2013) (citations omitted).

²¹ *Id.* at 337.

²² *Popowski v. Pa. Pub. Util. Comm’n*, 642 A.2d 648, 651 (Pa. Commw. Ct. 1994).

Tennessee recognizes this prohibition on retroactive ratemaking. Specifically, the appellate court has declared that “the Legislature never intended to extend retroactive ratemaking power” beyond what is expressly stated in what is now Tenn. Code Ann. § 65-5-103.²³

In this Docket, Tennessee Water is seeking to recover costs of providing water service to its customers in the aftermath of the 2016 wildfires in East Tennessee.²⁴ Specifically, Tennessee Water is proposing to recover its shortfall in revenue for 2017 through the “Make-Whole” Surcharge.²⁵ To do this, Tennessee Water first created a new class of customers called “inactive” customers.²⁶ This monthly surcharge for “inactive” customers is designed to recover “a combination of actual and forecasted losses for 2017.”²⁷ Since it is now the middle of the eleventh month of 2017, the majority of this surcharge represents the collection of purported under-recoveries or losses for a prior period, and it will be assessed against future rate-payers.

Although the setting of rates is a complex process, the application of the prohibition on retroactive ratemaking in this Docket is not. Ratemaking is prospective, therefore, rates may not be designed to recoup past losses or expenses.²⁸ In TPUC Docket No. 12-00030, TPUC recognized this prohibition on retroactivity when it: (1) approved on-going engineering and labor expenses but excluded past expenses and debt in the amount of \$26,000; (2) approved recurring annual permit fee expenses but excluded past penalties amounting to \$11,282.50; and (3) approved recurring wholesale water expense but excluded past expenses and debt resulting in a decrease in

²³ *S. Cent. Bell v. Tenn. Pub. Serv. Comm’n*, 675 S.W.2d 718, 719 (Tenn. Ct. App. 1984).

²⁴ *Petition* at 1.

²⁵ Tennessee Water’s Response to CPAD #1-26.

²⁶ Tennessee Water defines “inactive” customers as “a customer that has access to the water distribution system but does not currently have an active account and thus is not consuming water or being billed for water consumption.” Tennessee Water’s Response to CPAD #1-41.

²⁷ See Tennessee Water’s Responses to CPAD #1-28 and #1-37.

²⁸ *Pub. Serv. Comm’n v. Diamond State Tel. Co.*, 468 A.2d 1285, 1298-99 (Del. 1983) (citing *Transcon. & W. Air, Inc. v. Civil Aeronautics Bd.*, 336 U.S. 601, (U.S. 1949); *Bebchick v. Washington Metro. Area Transit Comm’n*, 485 F.2d 858 (D.C. Cir. 1973); *La. Power & Light v. La. Pub. Serv. Com’n*, 377 So.2d 1023 (La. 1979); *R.I. Consumers’ Council v. Smith*, 302 A.2d 757 (R.I. 1973)).

monthly approved expenses.²⁹ As the past expenses were barred in TPUC Docket No. 12-00030, Tennessee Water's attempt to recover past losses and expenses through the proposed "Make-Whole" Surcharge should also be barred. To allow such recovery would violate the prohibition of retroactive ratemaking.

Finally, it should be noted that the prohibition on retroactive ratemaking is consistent with the principle that utilities are granted only the opportunity to earn a fair rate of return, but not guaranteed a rate of return. To allow Tennessee Water to recover past losses would be a virtual guarantee of its rate of return and should not be permitted.

III. CONCLUSION

For the aforementioned reasons, the Consumer Advocate recommends the denial of the "Make-Whole" Surcharge so as to not violate the prohibition against retroactive ratemaking. It is against public policy and it is not in the best interests of consumers.

RESPECTFULLY SUBMITTED,



KAREN H. STACHOWSKI (BPR No. 019607)
Assistant Attorney General
Office of the Tennessee Attorney General
Public Protection Section
Consumer Protection and Advocate Division
P.O. Box 20207
Nashville, Tennessee 37202-0207
Phone: (615) 741-1671
Fax: (615) 532-2910
Email: karen.stachowski@ag.tn.gov

²⁹ *Order Denying Certificate of Public Convenience and Necessity and Requiring Divestiture of Water System, In Re: Petition of Laurel Hills Condominiums Property Owner Association for a Certificate of Convenience and Necessity*, pgs. 22, 24, 29-30 (April 18, 2013).


CERTIFICATE OF SERVICE

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

Ryan Freeman, Esq.
Baker, Donelson, Bearman, Caldwell & Berkowitz
1900 Republic Centre
633 Chestnut Street
Chattanooga, TN 37450-1800
Direct: 423.209.4181
E-mail: rfreeman@bakerdonelson.com

Joe A. Conner, Esq.
Baker, Donelson, Bearman, Caldwell & Berkowitz
1900 Republic Centre
633 Chestnut Street
Chattanooga, TN 37450-1800
Direct: 423.752.4417
E-mail: jconner@bakerdonelson.com

This the 8th day of November, 2017



Karen H. Stachowski
Assistant Attorney General