BEFORE THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE

January 14, 1999

IN RE:	)	
APPLICATION OF UNITED CITIES GAS	)	
COMPANY TO ESTABLISH AN	)	**DOCKET NO. 95-01134**
EXPERIMENTAL PERFORMANCE-BASED	)	**now DOCKET NO. 97-01364**
RATEMAKING MECHANISM	)	

FINAL ORDER ON PHASE ONE

MELVIN J. MALONE
CHAIRMAN

H. LYNN GREER, JR.
DIRECTOR

SARA KYLE
DIRECTOR

This matter came before the Tennessee Regulatory Authority (hereafter the "Authority" or "TRA") for decision on issues articulated in Phase One of the Application of the United Cities Gas Company (hereafter the "Company" or "United Cities") to establish an experimental performance-based ratemaking mechanism on August 18, 1998. This matter was heard by the Authority on March 26, 27, and 31, 1998. The findings of fact and conclusions of law rendered by the Authority on August 18, 1998, are set forth herein.

I. PROCEDURAL BACKGROUND

On January 20, 1995, United Cities filed an application with the Tennessee Public Service Commission ("TPSC") requesting that it be authorized to conduct a two-year experiment to determine whether the TPSC should change the way in which it determined whether the Company is performing reasonably in managing and acquiring gas supplies it sells to its customers. Instead of the TPSC reviewing United Cities' performance after-the-fact by way of a prudency review, as was traditionally done, United Cities proposed that the TPSC review its performance on an ongoing basis.[1] Under the proposal, United Cities' performance would be measured against pre-defined benchmarks which would act as surrogates for the market price of gas.

The proposal was to create an incentive for United Cities to perform better than ("out-perform") the market and to create a penalty if the Company's acquisition of gas supplies resulted in a price of gas above the pre-defined benchmarks. United Cities contended that under its

[1] Per the Purchased Gas Adjustment Rules (TRA Rule Section 1220-4-7-.05) an audit of the prudence of gas purchases applies to any gas company with operating revenues of $2,500,000 or more. The Rule states that a qualified consultant, hired by the TRA, is to evaluate and report annually to the TRA on the prudence of all gas costs which were incurred by the gas company during the previous year.

performance-based proposal, the Company would become more accountable to customers for its management and acquisition of gas supplies. If the Company out-performs the market, both the Company and the customers would benefit from sharing equally in the savings. If, on the other hand, United Cities' performance resulted in a price of gas above the pre-defined benchmark, the Company would absorb half of the costs in excess of an established deadband.

On May 12, 1995, after conducting a hearing on United Cities' application and after considering the evidence presented at the hearing by United Cities and the Consumer Advocate Division of the Office of the Tennessee Attorney General (the "Consumer Advocate"), the TPSC issued an order setting forth its unanimous decision approving the proposal in principle. The TPSC stated that changes in the natural gas industry prompted it to look "to incentive programs and more streamlined regulation to improve efficiency and hold down costs to consumers."[2]

Although the TPSC approved United Cities' proposal, the TPSC did make the following modifications and adopt the following conditions in regard to the Company's proposal. [3]

(1) United Cities would be limited to a maximum of $25,000 per month on gains and losses for all of the approved PGA mechanisms.

(2) The Gas Procurement Mechanism would be modified to include a 2% reasonableness zone that applies to both sides of the market. The Company would share equally with its customers all gas costs savings below 98% of the market and would also bear a share of the costs in excess of 102% of the market. In regard to the other mechanisms, 90% of all gains or losses would go to the consumers and 10% would go to the Company.

[2] Tennessee Public Service Commission Order dated May 12, 1995, page 4, paragraph 3.
[3] Tennessee Public Service Commission Order dated May 12, 1995, pages 4 and 5.

(3) The Company would be required to contract with an independent consulting firm to review this mechanism and report to the TPSC annually during the two-year experimental period. This review would not be an audit or a substitute for the current prudence review, which would no longer be necessary, but would be for the purpose of informing the TPSC if the proper incentives were in place and what, if any, further modifications should be made to the program.

(4) The TPSC would review the initiative in one (1) year and consider any proposed adjustments filed by the parties.

(5) Any proposed adjustments requested by the parties would be required to be filed not less than thirty (30) days nor more than sixty (60) days before the anniversary date of the program which shall be April 1.

(6) The TPSC would again review this matter in two (2) years to consider any further adjustments and whether the program should be made permanent.

There was no appeal of the TPSC's May 12, 1995, Order establishing the two-year experiment.

On February 2, 1996, the consultant's report which contained a review of the Company's performance as it related to the approved mechanism was provided to the TPSC. The consultant's report recommended certain modifications to the mechanism for the second year. Following the filing of the consultant's report, the TPSC received pre-filed testimony from United Cities and the Consumer Advocate. A hearing on the matter was held by the TPSC on March 5, 1996. Notwithstanding the objections of the Consumer Advocate, the TPSC took administrative notice of the report filed by the consultant. The TPSC did not permit the Consumer Advocate to cross-examine the consultant, Mr. Frank Creamer. On May 3, 1996, the TPSC issued an order modifying the mechanism/program in accordance with the consultant's report and directing the consultant to file a second report addressing the results from the second year of the experiment.

On June 27, 1996, the Consumer Advocate filed a petition for review of the May 3, 1996, Order in the Tennessee Court of Appeals. In the petition, the Consumer Advocate requested that the Court also review the TPSC's May 12, 1995, Order. On October 3, 1996, the Court issued an Order denying the request for a review of the May 12, 1995, Order on the ground that such request was not timely. With respect to the appeal of the May 3, 1996, Order, the Consumer Advocate maintained before the Court that it was denied due process when, during the hearing giving rise to the May 3, 1996, Order, the TPSC took official notice of Frank Creamer's consulting report without permitting the Consumer Advocate to effectively challenge the report. On March 5, 1997, the Court issued an Order in which it found that the TPSC's action in denying the Consumer Advocate access to all evidence considered by the TPSC and in failing to afford the Consumer Advocate an opportunity to impeach the same by cross-examination constituted a denial of due process. In sum, the Court concluded that the challenged action of the TPSC constituted a departure from "basic rules of fairness."[4] On June 30, 1996, the TPSC was dissolved by act of the legislature.

On February 28, 1997, the consultant filed his second report, which contained a review of the Company's performance during the second year of the mechanism. Among other things, the consultant recommended the implementation of a permanent performance-based ratemaking mechanism. In the consultant's judgment, the experiment proved that the mechanism provided demonstrable benefits to the Company's customers.

[4] *Tennessee Consumer Advocate v. Tennessee Regulatory Authority and United Cities Gas Company*, Court of Appeals, Middle District, No. 01A01-9606-BC-00286, March 5, 1997, page 6.

In a March 5, 1997, opinion, the Court of Appeals vacated the May 3, 1996, Order of the TPSC and remanded the case to the Authority "for such further proceedings and actions as it may deem appropriate including a reconsideration of the subject of the May 3, 1996, Order of the Public Service Commission." [5]

Following the entry of the Court of Appeals' March 5, 1997, Order, United Cities filed a petition on March 31, 1997, requesting that the Authority adopt the 1996 and 1997 reports of Frank Creamer and permanently approve the mechanism. The Consumer Advocate opposed this request. On May 20, 1997, the Authority ordered that a contested case be opened in this matter and appointed a Pre-Hearing Officer for the purposes of formulating the issues to be considered by the Authority and resolving discovery disputes between the parties. Thereafter, the parties engaged in extensive discovery which resulted in several pre-hearing conferences addressing discovery issues.

Prior to the beginning of the hearing, the Authority bifurcated this case to consider issues in the case remanded by the Court of Appeals (Phase One) separate from United Cities' petition seeking approval of a permanent performance based ratemaking mechanism (Phase Two). The Consumer Advocate took the deposition of Frank Creamer in advance of the hearings and, in accordance with the Court of Appeals' decision, conducted cross-examination of Mr. Creamer and of other witnesses during the hearings concerning Mr. Creamer's report. The hearings on both phases ran consecutively on March 26, 27, and 31, 1998. The Consumer Advocate conducted cross-examination of Frank Creamer during the hearing on Phase One on March 26, 1998.[6]

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5 *Id.*, at page 7.

6 TRA Hearing, United Cities Gas, Volume 1, March 26, 1998, page 69 through page 98; page 101 through 161; and page 177 through 180.

II. ESTABLISHMENT OF PHASE ONE ISSUES

As stated above, the TRA decided to address this matter in two (2) phases. Phase One would address the issues associated with the remand of the 1996 proceeding, including a review of the 1996 Creamer Report and a decision as to whether the mechanism should continue for the second year. Phase Two would address the issues raised in the 1997 petition filed by United Cities, including a review of the 1997 Creamer Report and a decision as to whether the mechanism should continue beyond its second year and be approved on a permanent basis. In order to adequately and properly address these issues, the Authority conducted a separate hearing for each phase. The hearing on Phase One was held on March 26 and 27, 1998, and the hearing on Phase Two was held on March 27 and 31, 1998. This Order on Phase One contains the findings of fact and conclusions of law made by the Directors with respect to Phase One issues only, as a separate order will be issued on Phase Two.

The issues for consideration during Phase One were developed by the parties during several pre-hearing conferences. Further, in advance of the hearing, the parties briefed three (3) specific threshold issues which were identified by the Pre-Hearing Officer in his Report of January 22, 1998, as follows:

1. Whether the parties should have access to staff information formulated for the Directors in preparation and final deliberation of this case.
2. Whether the TRA has the authority to approve incentive regulation.
3. Whether the Authority can establish ratemaking principles that are inconsistent with specifically articulated statutory terms.

III. FINDINGS OF FACT AND CONCLUSIONS OF LAW

A. Threshold Issues

1. Whether the parties should have access to staff information formulated for the Directors in preparation and final deliberation of this case.

Throughout this proceeding and other proceedings, the TRA has maintained the position that the staff recommendation memoranda sent to the Directors to assist them in their preparation of, and final deliberation of, the case are not discoverable. In advance of the hearings in this case, the Consumer Advocate sought the production of certain staff recommendation memoranda. However, the TRA resisted the production of such memoranda. In a case decided subsequent to the hearings but prior to the decision in this case, *Consumer Advocate Division v. Tennessee Regulatory Authority; Nashville Gas Company,*[7] the Court of Appeals concluded that documentation containing this type of information should be afforded a protection from discovery. In that case, the Consumer Advocate sought discovery from the TRA of a report which the Consumer Advocate claimed "augmented or boosted the position of one party or the other" and which had been prepared by a TRA staff member and submitted to an Authority member. The Court upheld the action of the TRA in denying the Consumer Advocate access to the report and stated:

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

[7] Court of Appeals, Middle District, No. 01-A-01-9708-BC-00391, July 1, 1998.

subject to the Consumer Advocate's motion to discover it.[8]

Per the *Nashville Gas* decision, staff recommendation memoranda to the Directors based on the evidentiary record are not subject to discovery. Although the hearings in this case took place prior to the *Nashville Gas* case decision, the Court's holding supports the action taken by the TRA in protecting these staff recommendation memoranda from discovery.

The Consumer Advocate also alleged that, prior to July 1, 1996, *ex parte* communications took place between William H. Novak of the TPSC staff, United Cities, and Mr. Creamer.[9] Because of the Consumer Advocate's allegation, Mr. Novak was removed from his role as advisor to the TRA Staff and the Directors, and testified as a witness in this case. The TRA permitted the Consumer Advocate to take the deposition of Mr. Novak concerning his conversations. The TRA also produced to the parties Mr. Novak's recommendation memoranda to the TPSC, which memoranda may have been based in part on conversations between Mr. Novak, the Company, and Mr. Creamer. The parties were also allowed to cross examine Mr. Novak during the hearing on Phase One about those conversations and the recommendations that he had previously made to the TPSC.

2. Whether the TRA has authority to approve incentive regulation.

3. Whether the Authority can establish ratemaking principles that are inconsistent with specifically articulated statutory terms.

The following addresses the above two (2) issues in tandem. An agency such as the TPSC, and now the TRA, acts within the scope of its authority when adopting regulations that are

[8] Court of Appeals, Middle District, No. 01-A-01-9708-BC-00391, July 1, 1998, page 5.

[9] The evidence at the Phase One hearing suggested that the Consumer Advocate also had direct conversations with Mr. Novak about the PBR mechanism outside the presence of the other parties to the case. (See TRA Hearing - United Cities Transcript, Volume II, March 27, 1998, page 327, lines 8 through 25; and page 328, lines 1 through 25.)

reasonably related to the purposes of its enabling statutes. An agency is permitted to exercise reasonable discretion in deciding the limit of that authority when it seeks to efficiently carry out the policy of the State as expressed in those statutes.[10] The TRA can act under Tenn. Code Ann. §§65-5-201 and 65-5-203 in establishing the rates to be charged under such a mechanism as proposed by United Cities. Pursuant to these statutes, the TRA has the discretion to approve proposed rate changes that have been submitted to it by a utility under its jurisdiction. The General Assembly has not provided a strict formula which the agency is to use in setting rates; rather, the General Assembly requires the rates set by this agency be just and reasonable. The TRA has the discretion under its enabling statutes[11] to determine what constitutes just and reasonable rates.

The above statements are not disputed by the parties. United Cities, arguing in support of the TRA's authority, states:

> It is well established that the General Assembly intended to leave rate-making to the Authority's technical competence and specialized knowledge.[12] The only limitation placed on the TRA is that the rates must be "just and reasonable." [13]

The Consumer Advocate argues that the TRA does not have "unbridled discretion," and states in this regard:

> In order to assure that the agency's actions are short of confiscation and extortion there must be a process that provides a meaningful hearing at a meaningful time and in a meaningful manner. The conditions for exercise of 203(a) power requires a finding after a full hearing that rates are just and reasonable. [14]

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[10] *McQueen v. McCanless,* 182 Tenn. 453, 187 S.W. 2d 630, 632 (Tenn. 1945).

[11] Tenn. Code Ann. Sections 65-5-201 and 65-5-203.

[12] *C.F. Indus. v. Tennessee Pub. Serv. Comm'n* 599 S.W.2d 536, 540 (Tenn. 1980).

[13] Tenn .Code Ann. Section 65-5-201; See also *Tennessee Cable Television Association, et al. v. Tennessee Public Service Commission,* 844 S.W. 2d 151, 159, and United Cities' Brief Relating to Threshold Questions Set Forth in the Hearing Officer's Supplement to the Pre-Hearing Conference Report, page 7.

[14] Consumer Advocate's Brief on Specific Issues, page 6.

Further the Consumer Advocate acknowledges in its Brief on Specific Issues that the rate proceeding initiated by United Cities before the TPSC was a Tenn. Code Ann. §65-5-203(a) proceeding and, as such, required an order that met §65-5-203(a)'s standards of justness and reasonableness. The Consumer Advocate also acknowledges the following general principles that operate when the TRA is exercising its authority to establish rates:

> Tenn. Code Ann. §65-1-213 provides that it is the duty of the Commission/Authority to ensure that the provisions of Title 65 and all laws of the state over which they have jurisdiction are enforced and obeyed. The duty the agency has to perform is a determination of justness and reasonableness. Only rates so established are presumed correct.[15]

In summary, both parties acknowledge the authority of the TRA to act to set rates in cases such as this. See *Tennessee Cable Television Association et al. v. TPSC, 844 S.W.2d 151, 159 (Tenn. 1992); CF Industries v. TPSC, 599 S.W.2d 536, 540 (Tenn. 1980).* The restriction placed on the TRA in setting rates, as argued by the Consumer Advocate, is that the TRA would be acting outside of its authority if it set rates that were unjust and unreasonable. The Consumer Advocate also argues that fundamental due process in the form of meaningful notice and a meaningful hearing must be afforded by the TRA in the process of establishing just and reasonable rates. The TRA has complied with fundamental due process requirements by providing meaningful notice and a meaningful hearing on United Cities' PBR mechanism. Indeed, by permitting discovery in this case and by providing the Consumer Advocate an opportunity to cross-examine Mr. Creamer and object to his report during the hearings, the TRA has corrected the denial of due process caused by the TPSC's actions, which resulted in the Court of Appeals' vacating the TPSC's May 1996, Order.

[15] *CF Indus. v. Tennessee Pub. Serv. Comm'n*, 599 S.W. 2d 536 (Tenn. 1980).

Although not originally identified as a threshold issue in this matter, the Consumer Advocate argued that the Authority must address as an initial issue the question of whether the Company's incentive plan is inconsistent with or in violation of the Purchase Gas Adjustment ("PGA") rule (TRA. Rule Section 1220-4-7-.01 et. seq.). The Consumer Advocate asserts that the plan violates the PGA Rule because it allows for recovery of more than the total cost of gas purchased for delivery to United Cities' customers.

By strict definition, "gas costs" are those costs which are paid to suppliers. The PGA Rule defines "gas costs" in the following manner at TRA Rule 1220-4-7.01:

> "Gas costs" shall mean the total delivered cost of gas paid or to be paid to Suppliers, including, but not limited to, all commodity/gas charges, ...and any other similar charges which are paid by the Company to its gas suppliers in connection with the purchase, storage or transportation of gas for the Company's system supply.

The general provisions of the PGA Rule (TRA Rule 1220-4-87-.02(2)) expand this definition somewhat as follows:

> These Rules are intended to apply to all Gas Costs incurred in connection with the purchase, transportation and/or storage of gas purchased for general system supply, transportation and/or storage of gas purchased for general system supply, including, but not limited to, natural gas purchased from interstate pipeline transmission companies, producers, brokers, marketers, associations, intrastate pipeline transmission companies, joint ventures, providers of liquefied natural gas (LNG), liquefied petroleum gas (LPG), substitute, supplemental or synthetic natural gas (SNG), and other hydrocarbons used as feed-stock, other distribution companies and end-users, whether or not the Gas Costs are regulated by the Federal Energy Regulatory Commission and whether or not the provider of the gas, transportation or storage is affiliated with the Company.

The PBR mechanism proposed by United Cities provides for a sharing of the gains of purchasing gas at prices lower than 98% of a basket of indices and a sharing of the losses of purchasing gas at prices greater than 102% of the same basket of indices. Notwithstanding the arguments of the Consumer Advocate, the "gas costs" remain the same whether or not sharing has taken place. While the computation of any savings or losses is directly tied to the "gas costs," the sharing itself is not part and parcel of the "gas costs" incurred by the Company.

The Consumer Advocate asserted that Mr. Novak of the TRA staff and Mr. Creamer, who was the consultant hired by the TPSC to review United Cities' plan, testified that adoption of the Company's proposal would permit the over collection of gas costs.[16] While the Consumer Advocate did question Mr. Creamer and Mr. Novak regarding this issue, their responses do not support the Consumer Advocate's position. Mr. Creamer testified that this additional money going to United Cities is not based on its actual cost of procurement and it is not intended to relate to the actual cost of procurement.[17] Mr. Novak testified that the staff interpreted the TPSC's order as a modification of the PGA rule.[18]

United Cities opposes the Consumer Advocate's argument that the plan violates the PGA Rule by asserting that the PGA Rule itself recognizes that the formulas contained in the rule could be modified from time to time. United Cities argued that Sections 1220-4-7-.03(1)(a)4 and (b)3 are both examples of how the rule itself recognizes that it can be modified without the necessity of a new rulemaking.[19]

The TPSC provided for incentive gas purchase costs to be included in the calculation of the gas procurement costs formula only when United Cities purchased gas below ninety-eight percent (98%) or above one hundred two percent (102%) of the market. The TPSC, in allowing for a modification of the PGA Rule in the gas procurement portion of the mechanism, acted reasonably

[16] Consumer Advocate Post Hearing Brief, page 10.
[17] TRA Hearing, United Cities Gas, Volume 1, March 26, 1998, page 144, lines 1 through 7.
[18] TRA Hearing, United Cities Gas, Volume 1, March 26, 1998, page 266, lines 18 through 21.
[19] Section 1220-4-7-.03(1)(a)(4) of the Rule states "the formulas may be modified from time to time to carry out the intent of these PGA Rules."

and did not abuse its discretion. Nor did the Agency interpret its rules in a manner that was either plainly erroneous or inconsistent with the intent of the PGA Rule.[20] Therefore, the Authority has determined that United Cities' plan is not violative of or inconsistent with the PGA Rule.

B. Phase One Issues

The Pre-Hearing Officer's January 22, 1998, Report recommended the following issues to the Authority as Phase One issues:

> 1. Is the May 12, 1995, Order of the TPSC active by virtue of the Court of Appeals vacating the May 3, 1996, Order?
>
>   a. Whether the activation of the 1995 Order by the TPSC constituted retroactive rate making.
>   b. Whether the May 12, 1995, Order institutes a just and reasonable rate, and
>   c. Whether United Cities has the burden to prove that any or all changes in rates are just and reasonable under Tenn. Code Ann. §65-5-203(a).
>
> 2. Whether, on remand, the TRA should adopt, non-retroactively, either in whole or in part, the recommendations made by the consultant in its report dated February 2, 1996, and approved by the TPSC in its May 3, 1996, Order.

These issues will be addressed individually.

1. Is the May 12, 1995, Order of the TPSC active by virtue of the Court of Appeals vacating the May 3, 1996, Order?

a. Whether the activation of the 1995 Order by the TPSC constituted retroactive rate making.
b. Whether the May 12, 1995, Order institutes a just and reasonable rate, and
c. Whether United Cities has the burden to prove that any or all changes in rates are just and reasonable under T.C.A. §65-5-203(a).

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[20] In *Environmental Defense Fund v. Tenn. Water Quality Board,* 660 S.W. 2d 776, 781 (Tenn. App. 1983), the Court stated that "[a] strict standard of review applies in interpreting an administrative regulation, and the administrative interpretation becomes of controlling weight unless it is plainly erroneous or inconsistent with the regulation." See also, *Jackson Exp. v. Tenn. Public Service Comm.,* 679 S.W. 2d 942 (Tenn 1984).

The Consumer Advocate argued that the May 12, 1995, Order issued by the TPSC was not a final order because it was "conditional upon additional studies by a consultant to determine just and reasonable rates."[21] In addition, the Consumer Advocate asserts that the May 12, 1995, Order was "a preliminary, procedural, or intermediate agency action ruling" that was rendered invalid by the Court of Appeals' decision dated March 5, 1997.[22] The Consumer Advocate relies on Tenn. Code Ann. §4-5-322(a)(1) for its position with respect to the May 12, 1995, Order. This section, however, refers to those intermediate orders that are immediately reviewable "...if review of the final agency decision would not provide an adequate remedy." The Consumer Advocate appears to assert a contradictory position in this argument, because the classification of an intermediate order is specifically for the purpose of obtaining immediate review of the action of any agency without the delay of waiting until a final order is entered. Even if the Consumer Advocate considered the May 12, 1995, Order an intermediate order, the Consumer Advocate did not attempt to seek review of it.

Further, the Consumer Advocate has not provided any legal authority from Tennessee statutes, the Uniform Administrative Procedures Act or Tennessee case law to support the assertion that the May 12, 1995, Order was not final. To the contrary, the Court of Appeals, in its Order dated October 3, 1996, dismissed the Consumer Advocate's attack on the May 12, 1995, Order on the basis that the attack was untimely and the Consumer Advocate had not filed a motion for reconsideration or a petition for review of that order within the requisite time period. Certainly if the May 12, 1995, Order had not been final or if the ability to appeal that Order was linked to the May 6, 1996, Order, the Court of Appeals would have permitted the Consumer Advocate to pursue

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21 Consumer Advocate Post Hearing Brief, page 2.
22 *Id.*

its attempt to have that Order reviewed by the Court. The language in the Court of Appeals' opinion to the effect that this agency could consider the May 12, 1995, Order in revisiting the TPSC's decision in the 1996 case was not a holding that the May 12, 1995, Order was not final. The conclusion that the May 12, 1995, Order was final and active renders moot any discussion concerning reactivation of that Order. Since the mechanism went forward from that Order, there is no issue of retroactive ratemaking concerning the May 12, 1995, Order.

The TRA finds that under Tennessee law, United Cities' two-year experimental PBR mechanism approved by the TPSC in 1995, instituted a just and reasonable rate because the evidence presented in 1995 and in this remand case, showed that the PBR proposal:

(1) fell within the "zone of reasonableness," and

(2) took into consideration the interests of both the consumer and the utility. [23]

Tenn. Code Ann. §65-5-201 imposes no limits on the factors the TRA may consider in approving rates. It is also well established that rates do not have to be determined using definite rules or precise formulas.[24] The May 12, 1995, Order constitutes a just and reasonable rate. The TPSC created a zone of reasonableness for rates by establishing a deadband supported by market indices and measured against the Company's historical activities. The record demonstrates the 1995 plan was theoretically sound and was not discriminatory. Therefore, the May 12, 1995, Order constituted a just and reasonable rate.

As to the burden of proof issue, the hearing was conducted with United Cities assuming the burden of proof in demonstrating the justness and reasonableness of the rates involved.

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[23] *Southern Bell Tel. & Tel. Co. v. Tennessee Pub. Serv. Comm'n*, 202 Tenn. 465, 471, 483, 304 S.W.2d 640, 648 (1957); *Tennessee Cable Television Association, et al. (TCTA) v. Tennessee Public Service Comm'n*, 844 S.W. 2d 151, 159 (Tenn. 1992).

[24] *Southern Bell Tel. & Tel. Co.*, at 648; *Tennessee Cable Television Association, et al*, at 159.

2. **Whether, on remand, the TRA should adopt, non-retroactively, either in whole or in part, the recommendations made by the consultant in its report dated February 2, 1996, and approved by the Tennessee Public Service Commission in its May 3, 1996, Order.**

The second of the Phase One issues deals with the 1996 Creamer Report prepared by Frank Creamer and the recommendations stated in Chapter IV of said report. The report separates the recommendations into short-term and longer-term recommendations. The short-term recommendations apply to the various mechanisms for the remaining year of the two-year experimental period. The longer-term recommendations apply to Phase Two, since they apply to the period immediately following the two-year experimental period.

The May 12, 1995, Order of the TPSC provided:

> The Commission will review this matter in one (1) year and consider any proposed adjustment filed by the parties...The Commission will again review this matter in two (2) years to consider any further adjustments and whether this program should be permanent.[25]

The independent consultant, Mr. Creamer, recommended four (4) modifications which the Company asserts should be adopted in their entirety.[26] These proposed modifications were as follows:

> 1. Increase the cap from $25,000 per month to $600,000 per year to be calculated annually.
>
> 2. Include storage swaps in the storage capacity cost incentive mechanism.
>
> 3. Modify the sharing arrangements to more closely match the risk reward profile and combine the capacity release mechanism for both storage and transportation. This modification would change the sharing arrangement of the seasonal pricing differential (Mechanism #2) and the storage gas commodity (Mechanism #3) from 90% / 10% to 50% / 50%. Mechanism #4 (Transportation Capacity Cost) and Mechanism #5 (Storage Capacity

[25] Order of the Tennessee Public Service Commission dated May 12, 1995, page 5.
[26] TRA Hearing - United Cities Gas Transcript, Volume I, March 26, 1998, page 41, lines 13 through 15.

Cost) would remain at 90% / 10% for the first $500,000 earned then decrease to a 80% / 20% for earnings thereafter.

4. Establish a direct reward system for employees that match their performance to the achievement of business goals.

Other than some brief discussions relating to Mr. Creamer's recommendation to increase the annual cap to $600,000, there were no substantive objections from the Consumer Advocate to Mr. Creamer's four (4) modifications. The TRA concludes that the issue of whether to accept the four (4) recommendations made by Mr. Creamer for the second year of United Cities' PBR experiment has been made moot by the passage of time. As set forth above, Mr. Creamer's recommendations and changes to the PBR mechanism were for a specific period of time; i.e., the second year of the experiment. Given the fact that the second year of the plan concluded on March 31, 1997, it would be impractical to make a determination on whether to accept the four (4) recommendations at the present time. As set forth in the procedural history herein, the impracticality is a direct result of action taken by the TPSC, which action was reversed by the Court of Appeals.

Further, to accept the first modification at this point in time could be construed as retroactive ratemaking. The second and third recommendations would have no material effect on the plan if the second year results mirrored those of the first year. The fourth recommendation would be difficult to implement in hindsight. The TRA, however, finds that, should it decide in Phase Two of this proceeding that United Cities' PBR mechanism should be made permanent, it may be appropriate to consider the recommendations made by Mr. Creamer on a going-forward basis.

Rather than dispute the consultant's modifications, the Consumer Advocate chose to present five (5) issues regarding the first year of the plan. The issues raised by the Consumer Advocate are as follows:[27]

1. The NYMEX should be excluded from the basket of indices.

2. There is no proof that the plan has improved United Cities' performance or benefited consumers.

3. The NORA contract should be excluded from United Cities' purchases because it predates the plan.

4. Affiliate party transactions mask the true economic impact of the plan.

5. The proposed plan is too complex.

The Directors addressed each of the issues presented by the Consumer Advocate at the August 18, 1998, Conference.

The first issue is whether NYMEX should be excluded from the basket of indices against which the Company's gas purchases are measured. The NYMEX is one of three widely published indices (the other two being Inside FERC and Natural Gas Intelligence) which are averaged together in this PBR mechanism to determine the benchmark against which United Cities' gas purchases are compared.

The Consumer Advocate's argument in support of excluding the NYMEX index is essentially that NYMEX is not a valid indicator for the following reasons: (1) NYMEX prices significantly overstate the market, (2) a regulatory authority in another state has concluded that NYMEX should not be a part of United Cities' incentive plan in that state, and (3) the use of NYMEX is clearly intended to reduce the Company's risk.[28] According to the Consumer Advocate, the use of NYMEX prices guarantees United Cities a "safe harbor" from true market

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[27] Consumer Advocate Division's Post Hearing Brief, pages 6 through 7.
[28] Consumer Advocate Division's Post-Hearing Brief, pages 12 through 15.

prices and flows nearly all of the incentive plan's benefits to the Company. Accordingly, the Consumer Advocate contended that the TRA should reject the use of the NYMEX as one of the indices in the proposed incentive plan.

Mr. Frank Creamer, in summarizing his February 2, 1996, Report, stated that "We also found that the benchmark of performance was generally found to be appropriate, and they served as a proxy for the market price and set a standard against which United Cities Gas purchasing decisions would be measured against in terms of gains and losses."[29] He disagreed with the Consumer Advocate that NYMEX is almost always higher than the other two indices, Inside FERC and Natural Gas Intelligence.[30] He testified that all the indices used by United Cities are widely followed by the gas industry, and, as such, are a valid proxy for the marketplace.[31] He also testified that NYMEX is a reliable index,[32] widely used by buyers and sellers in the marketplace, and used by other PBR plans in other states.[33] Mr. Creamer described the sampling techniques for the published indices used in establishing the benchmark for the incentive plan (Inside FERC, NYMEX, and Natural Gas Intelligence) and stated that they are all reliable.[34]

The Consumer Advocate contended that the Inside FERC index is clearly the most accurate index to approximate the actual historical cost of United Cities' non-swing purchases[35] (non-swing purchases are those purchases which are made at the beginning of each month for the month). The

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29 TRA Hearing - United Cities Gas Transcript, Volume I, March 26, 1998, page 63, lines 15 through 20.
30 TRA Hearing - United Cities Gas Transcript, Volume I, March 26, 1998, page 94, lines 12 through 14 and page 96, lines 8 through 19.
31 TRA Hearing - United Cities Gas Transcript, Volume I, March 26, 1998, page 97, lines 23 through 25; page 98, lines 1 through 10; and page 174, lines 10 through 15.
32 TRA Hearing - United Cities Gas Transcript, Volume I, March 26, 1998, page 100, lines 12 through 14.
33 TRA Hearing - United Cities Gas Transcript, Volume I, March 26, 1998, page 174, lines 10 through 21.
34 TRA Hearing - United Cities Gas Transcript, Volume I, March 26, 1998, page 98, lines 20 through 25; page 99, lines 1 through 25; and page 100, lines 1 through 14.
35 Consumer Advocate Division's Post-Hearing Brief, page 16, second paragraph.

Consumer Advocate claimed that Natural Gas Intelligence and NYMEX indices overstated the actual cost of gas.

United Cities disagreed with the Consumer Advocate that the NYMEX index is not an actual or real price for natural gas in the marketplace. United Cities pointed out that Mr. Creamer testified that real sellers and real buyers in the marketplace use the NYMEX index to buy and sell natural gas.[36] Mr. McDowell, on behalf of United Cities, testified to the same point.[37]

Based upon its review of the evidence contained in the record, the Authority finds and concludes that the NYMEX index should be retained as a part of the basket of indices after the first year of the plan. The NYMEX index is but one of several indices that are averaged together to determine the benchmark under United Cities' PBR mechanism/plan. The Authority is persuaded by Mr. Creamer's testimony that there is no inherent problem in using the NYMEX index as one of the indices in the PBR plan and that it is technically appropriate and sound to do so.[38]

The second issue raised by the Consumer Advocate is that there is no proof that the mechanism has improved the Company's performance or benefited the consumers. The Consumer Advocate argues that the plan has not benefited Tennessee consumers. One of the reasons given by the Consumer Advocate is that the index price is not reflective of what United Cities was paying before the incentive plan.[39] As noted earlier, the benchmark established for the plan is a

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36 TRA Hearing - United Cities Gas Transcript, Volume I, March 26, 1998, page 174, lines 10 through 15.

37 Prepared Direct Testimony of Ron McDowell dated August 13, 1997, page 15.

38 Chairman Malone disagreed with the majority on this issue. It is his opinion that United Cities failed to carry the burden in demonstrating that NYMEX is representative of the other indices used in the mechanism. For any mechanism of this type to be truly effective and not result in unwarranted and unintended pricing behavior, aberrations must be normalized. According to the Chairman, it matters little whether the component to be normalized is a well known national indicator, or an obscure formula misapplied. What is important is that any force or computational dynamics be normalized or removed to neutralize the ruinous effects of a skewed component.

39 TRA Hearing - United Cities Gas Transcript, Volume II, March 27, 1998, page 305, lines 11 through 17.

basket of indices, all of which are individually and collectively used by other gas entities as the "key price determinant in arm's length commercial contracts."[40] In establishing the benchmark for United Cities' gas procurement, the Company's purchases for the year ended June 30, 1994, were analyzed. Based on this analysis, Mr. Creamer testified that the TPSC set a standard of performance, or benchmark, for United Cities prior to the first year of the PBR experiment. Under that benchmark, gas purchases between 98 percent and 102 percent of the indices would be deemed prudent.[41] This tolerance zone, according to Mr. Creamer, was constructed to allow for the volatility in prices, security in supplies and the changes in the market from year to year.[42] Mr. Creamer also testified that the tolerance zone below the benchmark was constructed to account for United Cities' historical performance (including NORA)[43] in purchasing natural gas compared to the basket of indices. Mr. Creamer testified that absent the PBR mechanism, it would have been his expectation that United Cities' purchases would have been in the range of 98 percent to 102 percent. However, under the PBR experiment, because United Cities was able to buy gas below 98 percent of the indices, Mr. Creamer testified that this showed that the PBR mechanism had provided the appropriate incentives to deliver value to the customer and United Cities.[44]

The TRA agrees with the use of an external benchmark only if an adjustment (or deadband) has been made which reflects how the Company has performed historically to said benchmark. Therefore, by establishing a lower end deadband of 98%, the TPSC had effectively adjusted the benchmark to reflect United Cities' historical performance. The Consumer Advocate argued that

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[40] Prepared Direct Testimony of James R. Harrington dated August 13, 1997, page 23, lines 21 and 22.
[41] TRA Hearing - United Cities Gas Transcript, Volume I, March 26, 1998, page 86, lines 13 through 17.
[42] TRA Hearing - United Cities Gas Transcript, Volume I, March 26, 1998, page 88, lines 11 through 15.
[43] Per Daniel W. McCormac of the Consumer Advocate Division, the Company acknowledged in response to the Consumer Advocate's discovery request Item Number 10 that the Company's historical performance of purchasing gas at 98.7% of the benchmark, in fact, excluded the NORA contract. See Pre-filed Direct Testimony of Consumer Advocate Division witness Daniel W. McCormac, page 19, lines 15 through 19.
[44] TRA Hearing - United Cities Gas Transcript, Volume I, March 26, 1998, page 86, lines 17 through 22.

in order for the PBR mechanism to provide a benefit to United Cities' customers, the existing deadband around the benchmark should be set below the level that existed prior to the initiation of the PBR mechanism.

United Cities, on the other hand, argued that its performance in gas procurement should be judged by how its performance measures up against the current performance of other buyers in the market place and should not be measured against its own historical performance. According to United Cities, setting pre-determined standards, as suggested by the Consumer Advocate, using United Cities' own historical performance, would penalize United Cities which has historically performed well in this area, and award those local distribution companies that have historically performed poorly.[45]

Upon reviewing the record, the Authority agrees with the Consumer Advocate and finds that the existing deadband around the benchmark should be adjusted for the second year of the experimental period to one percent (1%) below the level that existed prior to the initiation of the PBR mechanism in order to ensure that the benefits gained therefrom are properly shared with United Cities' customers and to ensure that the Company only benefits when appropriate, as opposed to benefiting for behavior that would have taken place absent the deadband. The TRA reviewed the detail provided by the Company to the Consumer Advocate for its purchases during the period of July 1993 through June 1994,[46] and noted several instances where the Company had in fact purchased gas at a price which was less than 98.7% of the then applicable benchmark. Even those uninitiated in the art of mathematics recognize that the development of an arithmetic mean requires input values lower than the mean and input values higher than the mean. Thus, the

[45] TRA Hearing - United Cities Gas Transcript, Volume II, March 27, 1998, page 376, line 5 through page 380, line 1; Exhibits 12-15; Volume I, March 26, 1998, page 289, lines 11 through 17.
[46] Pre-filed Direct Testimony of Consumer Advocate Division witness Daniel W. McCormac, Exhibit 4.

deadband, as put forth by the Company and approved by the TPSC, contains a lower end that is inherently improbable not to beat. On the record before it, the Authority is unconvinced that the Company would not outpace the arithmetic mean absent much effort or motivation. Permitting such is clearly not in the public interest. Establishing the low end of the reasonableness zone or deadband at one percent (1%) below the historical pre-experiment purchase level and eliminating the NORA contract[47] from the PBR mechanism/plan results in the low end of the reasonableness zone being set at 97.7%. For Phase One purposes, the high end of the reasonableness zone shall remain at 102.0%.[48]

The TRA disagrees with the TPSC that the plan should allow for gains and losses to be computed on a transaction by transaction basis. Utilizing a transaction by transaction basis distorts, in favor of the Company, the true savings of a gas procurement mechanism. The Consumer Advocate presented testimony that "a single transaction could suggest savings of more than 2% while all other transactions could suggest losses of less than 2%. Although the total of all transactions for the year could show a loss, the Company would be rewarded for the savings achieved for the single transaction without incurring a penalty for the losses produced by all other transactions." [49]

The TRA agrees with the Consumer Advocate that computing gains and losses monthly rather than by transaction results in a more accurate computation of actual savings and losses and is a further deterrent to any "gaming" of the mechanism. Therefore, the TRA concludes that the mechanism should be modified for the second year to have the gains and losses computed on a monthly basis rather than transaction by transaction.

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[47] See discussion of NORA contract beginning on page 26 of this Order.
[48] Direct Greer disagreed with the majority on this issue and was of the opinion that the deadband as originally approved by the TPSC was appropriate.
[49] Pre-filed Direct Testimony of Daniel W. McCormac dated March 6, 1998, page 9, lines 17 through 25.

The Consumer Advocate asserts that the first nine months of the incentive plan cost the consumers more than what they would have paid had the incentive plan not been in place.[50] Under the Consumer Advocate's analysis, consumers would have paid $26,018,562 for gas costs for the nine months ended December 31, 1995, without the incentive plan. With the incentive plan, the consumers paid $26,130,221 which includes $111,659 for United Cities' share of the savings earned through the gas procurement mechanism.[51] To reach this conclusion the Consumer Advocate assumed that the Company's purchasing activities would have been identical during the period without the incentive plan.

The underlying theory of this type of ratemaking is that incentive plans result in changes in purchasing behavior which, in turn, result in gas being procured at a lesser price. During the hearing, Frank Creamer responded to this issue by stating:

> I would say of the $26,130,000, how does that compare to the standard of prudency as established by the mechanisms, and how that compares, it's $1.7 million less. Therefore, the results are $1.7 million less than the standard established for the prudency cost in the first year of the program.[52]

The Consumer Advocate's witness, Dr. Stephen Brown, agreed that the PBR mechanism/plan resulted in changes in purchasing behavior. Dr. Brown answered in the affirmative when asked, "...is it fair to say that once the PBR went into effect, United Cities went from purchasing above 102 percent to having no purchases above 102 percent." [53]

In determining whether performance based incentive plans are appropriate ratemaking, the regulator must first accept the external benchmark as an appropriate proxy for market price. Frank Creamer stated that the benchmark served as a proxy for the market price.[54] Mr. Novak agreed

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50 TRA Hearing - United Cities Gas Transcript, Volume II, March 27, 1998, page 316, lines 17 through 23.
51 Pre-filed Direct Testimony of Daniel W. McCormac dated March 6, 1998, page 15, lines 17 through 24.
52 TRA Hearing - United Cities Gas Transcript, Volume I, March 26, 1998, page 182, lines 19 through 25.
53 TRA Hearing - United Cities Gas Transcript, Volume II, March 27, 1998, page 430, lines 21 through 25.
54 TRA Hearing - United Cities Gas Transcript, Volume I, March 26, 1998, page 63, lines 15 through 18.

that the average of the three (3) indices are a proxy for market price.[55] Therefore, the TRA is of the opinion that if the Company is purchasing gas at less than the calculated deadband around an "arm's length" benchmark, and the calculated deadband was determined based on the Company's historical performance against said benchmark, then the ratepayers have, in fact, benefited.

Third, the Consumer Advocate contends that the NORA contract should be excluded from United Cities' purchases because said contract pre-dates the plan. The NORA contract is a seven (7) year gas purchasing contract that was negotiated by United Cities in 1993 prior to implementing its experimental incentive mechanism.[56] Neither party has disputed the benefits that the contract brought to the ratepayers of Tennessee.[57] The Company recognized this prior to implementing the plan. As Company witness Ron McDowell testified, the Company prepared an analysis of the benefits of including the NORA contract in its incentive mechanism prior to filing its proposal.[58]

United Cities maintains that the NORA contract should be included in the incentive mechanism. On behalf of the Company, Ron McDowell testified in his rebuttal testimony that "The NORA contract is an example of the type of innovative behavior that benefits the ratepayer and behavior which should be reinforced and encouraged by an incentive mechanism."[59] Mr. Novak testified that the reasonableness range of 98% to 102% took into account that the NORA contract would be included.[60] Although, as discussed more fully in footnote 43, it was

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55 TRA Hearing - United Cities Gas Transcript, Volume I, March 26, 1998, page 259, lines 17 through 18.

56 TRA Hearing - United Cities Gas Transcript, Volume I, March 26, 1998, page 79, lines 15 and 16; and Volume II, March 27, 1998, page 312, lines 3 and 4 and page 416, lines 13 and 14.

57 TRA Hearing - United Cities Gas Transcript, Volume II, March 27, 1998, page 417, lines 12 through 15; and Prepared Rebuttal Testimony of Ron McDowell, dated February 27, 1996, page 3, lines 1 and 2 (admitted into evidence, without objection, during hearing on March 26, 1998; see United Cities Gas Transcript, Volume I, March 26, 1998, page 185 lines 4 through 9).

58 TRA Hearing - United Cities Gas Transcript, Volume I, March 26, 1998, page 199, lines 9 through 15.

59 Prepared Rebuttal Testimony of Ron McDowell, dated February 27, 1996, page 3, lines 1 through 3 (admitted into evidence, without objection, during hearing on March 26, 1998; United Cities Gas Transcript, Volume I, March 26, 1998, page 185 lines 4 through 9).

60 TRA Hearing - United Cities Gas Transcript, Volume I, March 26, 1998, page 251, lines 5 through 8.

subsequently found through discovery that this assumption was in error.

Furthermore, the NORA contact does not require any change in behavior from the Company during the term of the contract.[61] Since the mechanism allowed for calculation of savings and losses on a transaction by transaction basis during the first year, United Cities made a profit on virtually every NORA transaction.[62] In fact, the savings generated amounted to a "windfall" for the Company.[63] Consumer Advocate witness Dr. Stephen Brown testified that approximately 71% of the savings experienced during the first nine months of the plan were directly attributable to the NORA contract.[64] If the NORA contract were not included in the incentive plan, 100 percent of those savings would be passed on the ratepayer. Dr. Brown testified that the NORA contract was beneficial to the ratepayer before the incentive plan and would also be beneficial in the absence of a plan. [65]

After considering the testimony given during the Phase One hearing, the Authority concludes that (1) the NORA contract existed prior to the PBR mechanism, and (2) it required no change in purchasing behavior by the Company. The NORA contract was not negotiated in response to the incentive mechanism, but acted as a catalyst to hasten the benefits derived therefrom. Including it in the incentive mechanism would "guarantee" a bonus to the Company. Thus, the Authority concludes that the NORA contract is to be excluded from United Cities' incentive mechanism after the first year of the plan. If, upon the expiration of the current contract and if the Company continues to operate under a PBR plan, the contract is renewed or renegotiated, it could be considered for inclusion in the mechanism at that time.

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[61] TRA Hearing - United Cities Gas Transcript, Volume II, March 27, 1998, page 411, lines 15 through 18.
[62] TRA Hearing - United Cities Gas Transcript, Volume I, March 26, 1998, page 94, lines 1 through 3.
[63] TRA Hearing - United Cities Gas Transcript, Volume I, March 26, 1998, page 250, lines 23 through 25 and page 251, lines 1 and 2.
[64] TRA Hearing - United Cities Gas Transcript, Volume II, March 27, 1998, page 415, lines 19 through 23.
[65] TRA Hearing - United Cities Gas Transcript, Volume II, March 27, 1998, page 431, lines 15 through 23.

Next, the Consumer Advocate argues that affiliate party transactions mask the true economic impact of the mechanism.[66] This issue is not relevant to the Phase One deliberations as there were no affiliate transactions during the first year of the plan.

Finally, the Consumer Advocate maintains that the proposed plan is too complex. The Consumer Advocate also contends that the plan leads to more errors.[67] The Consumer Advocate claimed that the record did not contain a complete description of the experimental plan.

After reviewing the record and the evidence presented in this case, the Authority finds and concludes that the Consumer Advocate's argument that the PBR mechanism is too complex is without merit.

IT IS, THEREFORE, ORDERED THAT:

1. The Tennessee Regulatory Authority has the statutory power to approve a performance-based incentive mechanism which automatically penalizes or rewards the public utility for its performance in procuring the natural gas that it sells to customers;

2. The parties to this proceeding are not entitled to have access to staff memoranda formulated for the Directors in preparation and final deliberation of this case;

3. United Cities' performance-based ratemaking mechanism does not violate the PGA Rule governing natural gas public utility companies;

4. The May 12, 1995, Order issued by the Tennessee Public Service Commission was not invalidated by the fact that the Court of Appeals vacated the Order issued by the Tennessee Public Service Commission on May 6, 1996. The May 12, 1995, Order of the Tennessee Public

[66] Consumer Advocate Division's Post-Hearing Brief, page 24.
[67] Consumer Advocate Division's Post-Hearing Brief, page 25.

Service Commission is active subject to further consideration and modification as is deemed appropriate by the Authority in this docket;

5. United Cities has the burden to prove that any and all changes in rates are just and reasonable under Tenn. Code Ann. §65-6-203(a);

6. Based upon the evidence presented in this case, the May 12, 1995, Order issued by the Tennessee Public Service Commission instituted a just and reasonable rate;

7. The May 12, 1995, Order issued by the Tennessee Public Service Commission did not constitute retroactive ratemaking;

8. The determination as to whether to accept the four recommendations made by Mr. Creamer in his report dated February 2, 1996, for the second year of the PBR experiment (April 1, 1996 - March 31, 1997) has been rendered moot as a result of the passage of time. The Authority, therefore, declines to accept or adopt the four recommendations made by Mr. Creamer in his report;

9. The NYMEX index, which is one of the three indices included in the basket used to determine the benchmark price of natural gas in United Cities' PBR ratemaking mechanism shall not be excluded from the basket of indices as proposed by the Consumer Advocate;

10. There is sufficient evidence contained in the record in this docket to show that United Cities' PBR ratemaking mechanism has improved United Cities' performance in purchasing natural gas and has benefited United Cities' customers;

11. The NORA contract should be excluded from the United Cities' PBR plan as proposed by the Consumer Advocate because the contract predated the existence of said plan;

12. The gains and losses under the plan should be calculated on a monthly basis rather than on a transaction basis;

13. The existing deadband around the benchmark price should be set for the second year at 1% below the level that existed prior to the initiation of United Cities' PBR plan as more fully discussed above in this Order;

14. Based upon the finding by the Authority that affiliate party transactions did not occur during the first year of the plan, such transactions will be considered under Phase Two;

15. Based upon the record in this case the Consumer Advocate's argument that United Cities' PBR plan is too complex is without merit;

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

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

CHAIRMAN

DIRECTOR

DIRECTOR

ATTEST:

EXECUTIVE SECRETARY