BEFORE THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE

June 9, 1999

IN RE:	)	
	)	
NASHVILLE GAS COMPANY APPLICATION FOR APPROVAL OF NEGOTIATED GAS REDELIVERY AGREEMENT WITH STATE INDUSTRIES	)	**DOCKET NO. 98-00338**
IN RE:	)	
	)	
NASHVILLE GAS COMPANY APPLICATION FOR APPROVAL OF NEGOTIATED GAS REDELIVERY AGREEMENT WITH BRIDGESTONE/FIRESTONE	)	**DOCKET NO. 98-00339**

INITIAL ORDER OF THE HEARING OFFICER

BACKGROUND

Effective January 1, 1998, Nashville Gas Company ("Nashville Gas" or the "Company") entered into oral agreements with State Industries and Bridgestone/Firestone to provide them with reduced rates pending the completion and filing of written agreements with the Tennessee Regulatory Authority ("Authority"). The written agreements were completed and filed with the Authority on May 12, 1998.[1] On January 22, 1999, the Authority issued orders (1) approving the two written agreements, (2) ordering that margin losses during the period January 1, 1998 to August 1, 1998 (Phase I) be absorbed 100% by Nashville Gas, and (3) ordering that margin losses for periods subsequent to August 1, 1998 (Phase II) be shared 10% by Nashville Gas and 90% by customers.

On February 5, 1999, Nashville Gas requested a rehearing of the Authority's orders. The Authority granted rehearing by orders dated April 14, 1999. The two proceedings were consolidated

[1] No interested party sought intervention in either docket.

for hearing on April 15, 1999. Director H. Lynn Greer, Jr. was appointed to serve as Hearing Officer for the purpose of conducting a hearing and rendering a decision on the merits of this proceeding. At the hearing, the testimony and exhibits of Nashville Gas witnesses Chuck W. Fleenor and Bill R. Morris were received into evidence.

Following the receipt of evidence, counsel for Nashville Gas proposed that the Authority resolve the various issues raised in the Company's request for rehearing by approving the two agreements to be effective January 1, 1998 and providing that all margin losses from January 1, 1998 be shared 10% by the Company and 90% by customers. In return, the Company would withdraw its objections to all issues. Counsel contended that this proposal would be fair to all parties and would avoid the various issues related to the applicability of Rate Schedule 9.[2]

The Hearing Officer requested that counsel file a motion to amend the petitions previously filed in these dockets and a brief regarding whether the Authority could grant the 90% / 10% sharing ratio for the period January 1, 1998 to May 12, 1998 without violating prohibitions against retroactive ratemaking. The written motions and brief were filed with the Authority on April 28, 1999.

FINDINGS AND CONCLUSIONS

EFFECTIVE DATE OF MARGIN LOSS

Based on the evidence presented at the hearing, the post-hearing brief filed herein, and the record as a whole, the Hearing Officer finds that the proposal presented by counsel at the hearing should be approved in part. In approving counsel's proposal in part, the Hearing Officer finds that Nashville Gas should be permitted to recover a 90% / 10% sharing ratio of margin losses for Phase I, with such ratio being permitted to run from May 12, 1998 through July 31, 1998. It is apparent from the pleadings in this case and the evidence presented at the hearing that the parties to the negotiations intended the rates for Bridgestone/Firestone and for State Industries to be effective

[2] More specifically, counsel stated that the issue of whether Rate Schedule 9 applied to the recovery of margin losses experienced in Phase I would be removed from consideration. *See* April 15, 1998 Hearing Transcript at 8-9.

January 1, 1998. The Authority has already approved the agreements that set forth the rates to be charged to these two customers, and no party to the same has objected to the approval of these rates. Therefore, the only issue before the Hearing Officer at this time is how Nashville Gas and its ratepayers should share the margin losses that result from these negotiated rates.

In its January 22, 1999 orders, the Authority decided that Nashville Gas should be permitted to recover 90% of its margin losses beginning August 1, 1998; however, the Authority decided that the Company should not be permitted to recover any of its margin losses that were incurred during Phase I. The reason for denying the recovery of the margin losses with respect to Phase I was based on the Authority's understanding that such recovery was being made pursuant to Rate Schedule 9, and as such, the applicability of that schedule to the particular facts herein was questionable at best.

At the hearing, counsel for Nashville Gas stated that the Company did not (and does not now) intend for the Authority to rule on the applicability of Rate Schedule 9. Furthermore, according to the Company, the Authority could avoid ruling on the applicability of Rate Schedule 9 by approving the Phase I rates under the negotiated contracts effective January 1, 1998. The Company reiterated that the parties always intended for the rates previously approved by the Authority to become effective in two phases. The rates in Phase I were intended to be pursuant to oral contracts which were later reduced to writing and filed with the Authority. The rates in Phase II were intended to be pursuant to the written agreements to be effective upon approval of the Authority. Although the Company mentioned Rate Schedule 9 in its two petitions as its authority for placing the Phase I rates into effect on January 1, 1998, the Authority's power to approve the Phase I rates under either the oral or the written contracts is not limited by the Company's action.

Rate Schedule 9 permits Nashville Gas, among other things, to negotiate lower rates for ratepayers and seek recovery of margin losses created by the threat of alternative fuel sources. In addition, the Authority has permitted gas utilities on a case by case basis to avoid threatened economic by-pass from large industrial customers by permitting the utility to negotiate a lower rate with those customers threatening such by-pass. The later practice results in special contracts being

offered pursuant to Tenn. Comp. R. & Regs. r. 1220 — 4 — 1 — .07. Specifically, this rule permits utilities to negotiate different rates for customers that are not provided for in general tariffs, schedules or rules. In both cases, however, the utility is able to avoid the loss of customers and the related contribution of margin. As a result, both the utility and its ratepayers benefit.

It is well settled that a public utility has the power to set its own rates; of course this is subject to review and approval by the Authority.[3] The utility has the burden to demonstrate that any increase, change or alteration of an existing rate or classification is just and reasonable.[4] In addition, Tenn. Comp. R. & Regs. r. 1220 — 4 —1 — .07 provides that the special contracts entered into between a utility and a ratepayer are subject to the review and approval of the Authority.

There is no question that the agreements in these dockets are special contracts subject to the review and approval of this agency. In approving the rates and conditions set forth therein, the Authority must be satisfied that such rates and conditions are just and reasonable. It is the opinion of the Hearing Officer that Nashville Gas has successfully demonstrated that the rates contained therein are in fact just and reasonable. However, with regard to the Company's request that the margin loss be approved back to January 1, 1998, the Hearing Officer finds that this condition is not reasonable based upon the record in these dockets.

The facts in these cases demonstrate that prior to January 1, 1998 (the date upon which the

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[3] *See Consumer Advocate Division v. Bissell*, 1996 WL 482970 (Tenn. App., Nashville, Aug. 26, 1996); *Consumer Advocate Division v. Tennessee Regulatory Authority*, 1998 WL 684536 (Tenn. App., Nashville, July 1, 1998); *Cumberland Tel. & Tel. Co. v. Public Utilities Commission*, 287 F. 406 (M.D. Tenn. 1921). Copies of the unpublished opinions are attached hereto as collective **Exhibit A**.

[4] *See* Tenn. Code Ann. § 65-5-203(a).

rate decrease for State Industries and Bridgestone/Firestone became effective), Nashville Gas was notified by these ratepayers that if the transportation rates were not reduced, these ratepayers would seek by-pass. On December 30, 1997, Nashville Gas notified the Authority of the rate decrease it would provide to Bridgestone/Firestone, however, no such notification was provided to the Authority concerning the rates for State Industries. Nashville Gas entered into written contracts with Bridgestone/Firestone and with State Industries on April 14, 1998 and on April 24, 1998, respectively. Finally, despite the fact that the rates became effective on January 1, 1998, Nashville Gas did not seek relief concerning margin loss until it filed the Petitions seeking approval of the underlying agreements (or special contracts) on May 12, 1998.

It is under these facts that the Hearing Officer has determined that Nashville Gas could have filed its petitions seeking approval of these agreements at the time the contracts became effective. Even though Nashville Gas did notify the Authority concerning the Bridgestone/Firestone rates, it took no action to do the same concerning the rates for State Industries. When Nashville Gas took affirmative action to reduce the rates for these two ratepayers, it became aware that it would suffer a loss. Thus, Nashville Gas could have filed the appropriate pleadings with the Authority as early as January 1, 1998, seeking relief from this known margin loss. For these reasons, the Hearing Officer finds that it is reasonable to permit Nashville Gas to recover its margin loss as set forth in its amended petitions effective May 12, 1998.

At the hearing, the Hearing Officer expressed a concern as to whether the Authority could approve the sharing arrangement for the period beginning January 1, 1998 and ending on May 12, 1998. The Company was requested to file a brief addressing this matter, and the brief was filed on April 28, 1999. After reviewing the brief, the Hearing Officer finds that the Authority can approve the sharing arrangement as outlined hereinabove and that doing so will not constitute unlawful

retroactive ratemaking. As pointed out in the Company's brief, the Company is not proposing to change any rates retroactively. The rates that became effective January 1, 1998 were implicitly approved when the Authority approved the contracts between the parties, no party has objected to those rates, and the Company does not propose to change those previously approved rates. In short, no rates are being changed retroactively. The only issue in these proceedings is how the margin losses will be shared. Any sharing of margin losses will take place through the Company's Actual Cost Adjustment5 and will be recovered in future rates to be collected on a prospective basis.

In *American Association of Retired Persons v. Tennessee Public Service Commission*, 896 S.W.2d 127 (1994) (*Permission to Appeal Denied by Supreme Court*, Feb. 27, 1995) ("*Retired Persons*"), the Tennessee Public Service Commission adopted rules that provided for the sharing of telephone company earnings in excess of a certain range between the telephone company and its customers. On appeal, the appellants contended that the sharing of past earnings resulted in retroactive rate making. The Court of Appeals for the Middle District of Tennessee disagreed. The Court held that since the sharing of past excess earnings would be effected through prospective rate reductions, rates would not be retroactively changed and, therefore, the prohibition against retroactive ratemaking was inapplicable.

In the instant case, the Authority is not being requested to effect the 90% / 10% sharing of margin losses in a retroactive manner. As was the situation in Retired Persons, the sharing between the Company and its customers will be effected in prospective rates. As a result, no rate is being adjusted retroactively. The only distinction between the Retired Persons case and the instant case is that in the first case the sharing was of earnings and in the second case the sharing is of losses. Since earnings and losses are simply the converse of each other and are reported on the same line of the income statement, this is clearly a distinction without a difference.

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[5] *See* Tenn. Comp. R. & Regs. r. 1220 — 4 —7 — .03(c).

IT IS THEREFORE ORDERED THAT:

1. The Company's motions to amend its petitions in Docket Nos. 98-00338 and 98-00339 are granted.

2. The Authority's January 22, 1999 orders in Docket Nos. 98-00338 and 98-00339 are amended to provide for approval of the negotiated agreements effective as of May 12, 1998 and a 90% / 10% sharing between ratepayers and the Company of margin losses under such agreements until the Company's next general rate case.

3. Any party aggrieved by this Initial Order may file a Petition for Reconsideration with the Tennessee Regulatory Authority within ten (10) days from and after the date of this Order. The Hearing Officer presiding herein shall consider such petition.

4. Any party aggrieved by this Initial Order may file a Petition for Appeal pursuant to Tenn. Code Ann. § 4-5-315 with the Tennessee Regulatory Authority within ten (10) days from and after the date of this Order. Additionally, if any Director of the Authority or any party herein do not seek review of this Initial Order within the time prescribed in Tenn. Code Ann. § 4-5-315, this Order shall become the Final Order.

Director H. Lynn Greer, Jr., as Hearing Officer

Attest:

K. David Waddell, Executive Secretary

SEE COURT OF APPEALS RULES 11 AND 12

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

No. 01-A-01-9601-BC00049.

Court of Appeals of Tennessee.

Aug. 28, 1996.

Rehearing Overruled Sept. 18, 1996.

APPEALED FROM THE PUBLIC SERVICE COMMISSION AT NASHVILLE, TENNESSEE

Charles W. Burson, Attorney General & Reporter Commission, Michael E. Moore, Solicitor General, David W. Yates, Associate Consumer Advocate, Nashville, Tennessee, for petitioner/appellant.

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

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

OPINION

CANTRELL, Judge.

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

I.

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

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

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

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

II.
Ratemaking In General

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

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

Id. § 81.

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

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

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

***2** Tenn.Code Ann. § 65-5-201.

That chapter also provided:

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

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

Tenn.Code Ann. § 65-5-203(a)(b)(1).

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

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

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

> FN3. We should note also that the Commission has

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

III.
Retroactive Ratemaking

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

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

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

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

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

IV.
Due Process

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

> Whether notice and a hearing in proceedings before a public service commission are necessary depends chiefly upon the statutory or constitutional provisions applicable to such proceedings, which may make notice and hearing prerequisite to action by the commission, and upon the nature and object of such proceedings, that is, whether the proceedings are, on the one hand, legislative and rule-making in character, or are, on the other hand, determinative and judicial or quasi-judicial, affecting the rights and property of private or specific persons.
>
> 64 Am.Jur.2d Public Utilities § 266.

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

We hold that the tariff does not violate the due process rights of the rate- payers because it raises or

lowers their rates without a hearing.

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

LEWIS and KOCH, JJ., concur.

END OF DOCUMENT

SEE COURT OF APPEALS RULES 11 AND 12

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

No. 01A01-9708-BC-00391.

Court of Appeals of Tennessee.

July 1, 1998.

Appeal No. 01-A-01-9708-BC-00391 Tennessee Regulatory Commission.

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OPINION

CANTRELL, J.

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

I.

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

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

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

II. The Procedural Issues

a.

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

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

The TRA, however, is also governed by an elaborate set of procedural statutes. See Tenn.Code Ann. § 65-2-101, et seq. Tenn.Code Ann. § 65-2-111 provides that the TRA may direct that contested case proceedings be heard by a hearing examiner, and we held in Jackson Mobilphone Co.

v. Tennessee Public Service Comm., 876 S.W.2d 106 (Tenn.App.1994), that the TRA's predecessor, the Public Service Commission, could conduct a contested case hearing itself or appoint a hearing officer. We think that decision is still good law and that it applies to the TRA.

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

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

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

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

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

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

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

The Agency members unanimously denied the CAD's motion.

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

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

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

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

c.
Did NGC unlawfully put its new rates into effect on

January 1, 1997?

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

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

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

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

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

In addition, Tenn.Code Ann. § 65-2-112 says "Every final decision or order rendered by the authority in a contested case shall be in writing, or stated in the record...." NGC could have used the TRA's oral decision as the basis for its action of putting the rates into effect. The decision had been "stated in the record" on December 17, 1996. We add this caveat, however. The statute goes on to say that either a written or oral decision "shall contain a statement of the findings of fact and conclusions of law upon which the decision of the authority is based." We do not express an opinion on whether the December 17 oral decision complies with that mandate. But we do agree that findings of fact and conclusions of law are a necessary requirement for a meaningful review of an administrative agency's decision. See Levy v. State Bd. of Examiners for Speech Pathology & Audiology, 553 S.W.2d 909 (Tenn.1977).

III. The Substantive Issues

a. Hearsay

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

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

b. Advertising

This is an issue on which the briefs of the principal parties seem to be speaking different languages. The following explanation is the best we can glean from

the record. In 1984 the Public Service Commission adopted a rule that disallowed as a recoverable expense by a utility any "promotional or political advertising." The prohibition covered advertising for the purpose of encouraging any person to select or use gas service or additional gas service. It did not cover (among other things) advertising informing customers how to conserve energy or to reduce peak demand for gas, or advertising promoting the use of energy efficient appliances. See former Rule 1220-4-5-.45, Tenn. Regis.

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

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

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

c. The Long Term Incentive Plan

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

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

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

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

d. Rate of Return

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

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

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

IV. The Rate Design

The intervenor, AVI, challenges the part of the TRA's order that raised the "tailblock" rate for gas supplied to NGC's largest interruptible customers. The tailblock rate is the lowest rate charged per unit and it applies to usage of over 9,000 decatherms per

month. [FN1] NGC's petition did not seek any increase in the rates falling in this category. The CAD's proof proposed that any changes be spread to all customer classes, but the intervenor sought an overall rate decrease. AVI's witness testified that industrial rates were set well above costs and should not be increased The TRA's order increased the tailblock rate from $0.21 per decatherm to $0.228 per decatherm. The TRA said in its order:

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

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

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

> Specifically, there is no requirement in any rate case that the Commission receive and consider cost of service data, or what such data, if in the record, are to be accorded exclusivity. It is self-evident that cost of service is of great significance in the establishment of rates but is of lesser value in arriving at rate design. A fair rate of return to the regulated utility is one thing; the establishment of rates among various customer classes is quite another.
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> 599 S.W. at 542.
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> * * *
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> Thus, the Public Service Commission in rate making and design cases is not solely governed by the proof although, of course, there must be an adequate evidentiary predicate. The Commission, however, is not hamstrung by the naked record. It may consider all relevant circumstances shown by the record, all recognized technical and scientific facts pertinent to the issue under consideration and may superimpose upon the entire transaction its own expertise, technical competence and specialized knowledge. Thus focusing upon the issues, the Commission decides that which is just and reasonable. This is the litmus test--nothing more, nothing less.
>
> 599 S.W. at 543.

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

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

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

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