BEFORE THE TENNESSEE REGULATORY AUTHORITY
AT NASHVILLE, TENNESSEE

PROCEEDING FOR THE PURPOSE OF ADDRESSING COMPETITIVE EFFECTS OF CONTRACT SERVICE ARRANGEMENTS FILED BY BELLSOUTH TELECOMMUNICATIONS, INC. IN TENNESSEE	)	DOCKET NO. 98-00559

CONSUMER ADVOCATE DIVISION'S BRIEF ON THRESHOLD ISSUES

Comes the Consumer Advocate Division, pursuant to the request of the Directors of the Tennessee Regulatory Authority ("TRA"), and hereby files its Brief on Threshold Issues.

I. THE BURDEN OF PROOF IN THIS DOCKET

This docket was opened by the TRA in order to investigate the competitive effects of contract service arrangements filed by BellSouth Telecommunications, Inc. Under Tenn. Code Ann. § 65-4-117(1), the TRA has the power to "[i]nvestigate, upon its own initiative or upon complaint in writing, any matter concerning any public utility as defined in § 65-4-101." Accordingly, insofar as the TRA is investigating BellSouth's contract service arrangements ("CSAs"), the TRA has the burden of proof.

If any party intends to argue that BellSouth's CSAs are anticompetitive and requests the TRA to take action against BellSouth, that party would jointly have the burden of proof with the TRA.

II. THE NATURE OF RELIEF AVAILABLE

At least one portion of the relief should be retrospective: all CSAs should be amended to reflect fair termination charges. Thus, the TRA should not allow any termination clause that attempts to penalize a customer for changing telephone companies.

III. WHETHER PROCEEDING WITH THIS DOCKET AS A CONTESTED CASE IS CONSISTENT WITH TENNESSEE CABLE TELEVISION

In Tennessee Cable Television Association v. Tennessee Public Service Commission, 844 S.W.2d 155 (Tenn. App. 1992), the Tennessee Court of Appeals set forth factors to consider when there is an issue of whether an agency should proceed by rulemaking rather than a contested case. In general, rulemaking should be used when an agency's action is concerned with broad policy issues that affect a large segment of a regulated industry or the general public. 844 S.W.2d at 162.

In the present case, the focus is on only one company: BellSouth. In particular, the TRA is gathering information and analyzing it to determine the anticompetitive effects of BellSouth's CSAs. Accordingly, the Consumer Advocate Division believes that it is possible for the TRA to proceed with the present case as a contested case rather than rulemaking. If, at the end of the case, the TRA wishes to convene a rulemaking docket to draft rules applicable to other companies, it can do so. To turn the present case into a rulemaking, however, would be to shift the focus from BellSouth and its uniquely dominant market position.

IV. WHETHER CONTRACT SERVICE ARRANGEMENTS MAY BE APPROVED BY THE AUTHORITY CONTINGENT UPON THE CONCLUSION OF THIS DOCKET AND SUBJECT TO ABROGATION OR MODIFICATION BASED UPON THE DECISION OF THE AUTHORITY IN THIS DOCKET

Board of Waterworks of Baxter v. Smith Utility District, filed March 6, 1987, 1987

WL 7328, (Tenn. Ct. App.) and City of Parsons v. Perryville Utility District, 594 S.W.2d 401 (Tenn. Ct. App. 1979) stand for the proposition that no provision of a contract inconsistent with a statute can be enforced. The contracts in this case are between BellSouth and its selected special customers. At this point, the primary focus of the TRA investigation is on the termination provisions of the contracts. The TRA should not allow the termination provisions and penalties in such contracts unless BellSouth proves that the penalties are rationally related to BellSouth's costs. If any person is adversely affected by a contract, that person or his representative can file a complaint regarding the contract.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing Brief on Threshold Issues has been faxed and or mailed postage prepaid to the parties listed below this 15th day of June, 1999.

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SEE COURT OF APPEALS RULES 11 AND 12

BOARD OF WATERWORKS OF THE CITY OF BASTER, Tennessee, Plaintiff-Appellee,
v.
SMITH UTILITY DISTRICT OF SMITH COUNTY, Tennessee, Defendant-Appellant.

Court of Appeals of Tennessee, Middle Section, at Nashville.

March 6, 1987.

No. 86-324-II Smith Equity, Appealed From The Chancery Court of Smith County at Carthage, Tennessee.

H.S. Barnes, Barnes & Acuff, Cookeville, for plaintiff-appellee.

James L. Bass, Bass & Bass, Carthage, for defendant-appellant.

OPINION

CANTRELL, Judge.

***1** The Board of Waterworks of the Town of Baxter, Tennessee sued one of its customers, Smith Utility District of Smith County, Tennessee, to have the court determine the proper rate to be charged and the amount due for prior sales of water under a contract between the parties. The Utility District appeals a judgment in favor of the Board on the ground that the chancellor arbitrarily fixed the rate applicable under the contract and the amount due the Board.

The water system operated by the Board of Waterworks of the Town of Baxter buys water from the town of Cookeville and resells it to customers in and around the City of Baxter. The customers are charged according to a rate structure that includes the following categories: customers inside the city limits of Baxter, residential users outside the city limits, and a master meter category applicable to customers outside the city that purchase water in large quantities.

In 1979 the Utility District entered into an agreement with the Board whereby the Board would furnish water to the Utility District for resale to the Utility District's customers in a part of Smith County. The initial rate provided in the agreement was one dollar per thousand gallons and was subject to being increased on a pro rata basis if the Town of Cookeville increased the wholesale rate to the Board. The contract also contained another provision concerning the adjustment of rates:

"5. (modification of Contract) That the provisions of this contract pertaining to the schedule of rates to be paid by the purchaser for water delivered are subject to modification at the end of every _____ year. Any increase or decrease in rates shall be based on a demonstrable increase or decrease in the cost of performance hereunder, but such costs shall not include increased capitalization of the seller's system. Other provisions of this contract may be modified or altered by mutual agreement."

In 1979 the Town of Cookeville charged the Board fifty-five cents per thousand gallons of water consumed. The rate charged by the Town of Cookeville increased several times until April of 1983 when the rate was set at the current level of ninety cents per thousand gallons. The Board, however, did not precisely follow its contract with the Utility District and pass along the increase on a pro rata basis. Instead, the Board,in a haphazard way raised its rates in such amounts and at such times that no correlation can be detected between the amount paid to the Town of Cookeville and the amount charged the Utility District. In fairness to the Board it should be pointed out that the Utility District was undercharged until May of 1983 when the Board changed the rate from $1.50 per thousand to $3.00 per thousand. When the, Utility District refused to pay the increased rate and insisted that the proper rate based on the contract was $1.64 per thousand the Board brought this action.

The precipitating factor for the large rate increase in May of 1983 was a letter from the State Comptroller's office on December 30, 1982 stating that the water and sewer system for the City of Baxter operated at a $41,859.23 loss during the fiscal year ending June 30, 1981. The letter pointed out that operating at a loss violated the provisions of T.C.A. § 7-35-414 which required any city operating a water system to charge rates sufficient to pay all reasonable expenses of operation, repairs, and maintenance; to provide for a sinking fund for the payment of principal and interest of bonds; and to maintain an adequate depreciation account. The letter also required the city to report within sixty days the action taken to correct the situation.

***2** In response to the letter from the State Comptroller the manager of the Board arbitrarily designed a rate structure that he thought would provide the necessary

funds to operate the system. This rate structure included the $3.00 per thousand gallon rate which the Utility District refused to pay.

After the hearing below the chancellor held that the provisions in the contract setting rates violated the statutory provision cited above; that, however, the rate of $3.00 per thousand gallons was not a fair and equitable rate and was therefore discriminatory; and that the Board's proof failed to meet the statutory requirements of a definite, technical cost ratio to supply the financial needs, of the system. After making those findings the chancellor himself set the rate for the Utility District at the same rate being charged the other customers outside the city limits of Baxter and made the new rate retroactive to May 1, 1983.

The Utility District insists that the chancellor erred in ignoring the contract rate provisions. The Board insists that the contract rate provisions are subject to the statutory requirements that the Board charge rates that are sufficient to provide funds for the purposes set out in T.C.A. §7-35-414. In addition the Board insists that the rates set by the Board are presumed to be correct and that the burden is on the Utility District to prove otherwise.

On the question of whether the contract rate provisions are controlling, we are of the opinion that both parties are correct to a certain extent. Starting from the proposition that a municipal water system will be bound by its contract to furnish water to a consumer at certain specified rates, 94 C.J.S., Waters, §287 (2), we also recognize that the contract rates cannot be so low that the system cannot meet the requirements of T.C.A. § 7-35-414.

In City of Parsons v. Perryville Utility District, 594 S.W.2d 401 (Tenn.App. 1979), this court dealt with a part of the same problem under review here. In that case the contract between the parties included a provision identical to paragraph five of the contract in this case. The court held that despite the contractual provisions to the contrary where the water supplier had been required to borrow money to correct deficiencies in its plant, the purchaser could be required to pay rates that included a sum required to pay the increased capital obligation. The court in that case said:

Viewing Chapter 68 of the Public Acts of 1933 (T.C.A. §6-1408 through §6-1439) [now §7-35-401 through §7-35-432] as a whole, we do not believe that T.C.A. §6-1423 (now §7-35-416] empowering the City to contract with the District may be construed to defeat the specific obligation with regard to rates imposed by T.C.A. §6-1421 [now §7-35-414]. Under the last mentioned Section the City has the duty to establish and maintain just and equitable rates, and it is specifically provided that such rates and charges shall be adjusted so as to provide funds sufficient to pay all reasonable expenses of operation, repair and maintenance, provide for a sinking fund for payment of principal and interest of bonds when due, and maintain an adequate depreciation account. It is further provided that such rates may be readjusted as necessary from time to time. Therefore, the City had no power to bind itself to a rate for fortyfive years which was not subject to increase to reflect the costs of increased capitalization of the system. The legislature imposed upon the City a continuing duty to revise rates to enable the system to be financially selfsufficient while maintaining an equitable rate structure. That portion of Section no. 5 of the contract which precludes consideration of increased capitalization in connection with the modification of rates operates as a bar to this statutorily required flexibility and, therefore, is inconsistent with the explicit legislative intent. Further, such agreement amounts to unjust discrimination under the common law since it imposes on the direct customers of the City residing within its corporate limits losses which are caused by its failure to charge rates to the District which reflect the cost of capital improvements to the system. Accordingly, we find this portion of the contract to be in violation of both the statutory and common law. 594 S.W.2d at 407.

***3** Thus, the court held that the purchaser could not rely on that section of paragraph five which exempted the purchaser from paying rates based on increased capitalization. The court however went on to say:

We do not find that the contract as a whole is ultra vires as insisted by the City. The separate portions thereof are divisible, and the remainder is enforceable independent of the portion of Section no. 5 which is void.

Thus, we conclude that the contract involved in this case is enforceable by either party except that the Utility District cannot use Section Five to avoid paying its fair share of any necessary increased capitalization costs. Parenthetically, we would also say that we think the rule announced in City of Parsons applies where the rates set by the contract in the first instance were unreasonably low in light of the requirements of T.C.A. §7-35-414. We do not decide that question

here, however, because the Board has not made that an issue in the court below or on appeal. So far as the record in this case shows the rates set by the agreement of the parties in 1979 were entirely adequate.

In following the contract provisions the Board would be allowed to charge the Utility District a rate that is increased by the same pro rata amount as the rates paid by the Board to the Town of Cookeville plus any further increase that is a result of a demonstrable increase in the cost of performance.

The Board did not attempt to prove any increase in its cost of performance. On this issue we hold that the Board has the burden of proof, although the Board argues that rate making is a legislative function and the rates set by ordinance are presumed to be reasonable. We think the rule is otherwise where the Board is trying to alter the rates set by contract. See 94 C.J.S., Waters, §287(2). Therefore, the Board has failed to show any reason for increased rates under the contract other than the pro rata amount based on the increase by the Town of Cookeville. As we have indicated that figure is $1.64 per thousand gallons.

The decision of the court below is reversed and the cause is remanded for a determination of the amount due the Board, if any, under its contract with the Utility District. This decision is without prejudice to the Board to insist on any future increases that may prove to be necessary. Tax the costs on appeal to the Board.

LEWIS and KOCH, JJ., concur.

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