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Ectory Lawless, Docket Manager
Tennessee Public Utility Commission
502 Deaderick Street, 4th Floor
Nashville, TN 37243
TPUC.DocketRoom@tn.gov

RE: ***Petition of Limestone Water Utility Operating Company, LLC to Elect and Opt into an Annual Rate Review Mechanism and ARRM Tariff Pursuant to Tenn. Code Ann. § 65-5-103(d)(6)*, Docket No. 26-00070**

Dear Ms. Lawless:

Attached for filing please find *Limestone Water Utility Operating Company, LLC's Response to Consumer Advocate's Motion to Dismiss* in the above-captioned matter.

As required, copies will follow. Should you have any questions concerning this filing or require additional information, please do not hesitate to contact me.

Very truly yours,

BUTLER SNOW LLP

Melvin J. Malone

clw
Attachment
cc: Russ Mitten, Limestone
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BEFORE THE TENNESSEE PUBLIC UTILITY COMMISSION
NASHVILLE, TENNESSEE

PETITION OF LIMESTONE WATER UTILITY OPERATING COMPANY, LLC TO ELECT AND OPT INTO AN ANNUAL RATE REVIEW MECHANISM AND ARRM TARIFF PURSUANT TO TENN. CODE ANN. § 65-5-103(d)(6)	**)))))))**	**DOCKET NO. 26-00070**

LIMESTONE WATER UTILITY OPERATING COMPANY, LLC'S RESPONSE TO CONSUMER ADVOCATE'S MOTION TO DISMISS

Pursuant to Rule 1220-01-02-.06(2) of the Tennessee Public Utility Commission's Rules of Practice and Procedure, Limestone Water Utility Operating Company, LLC's ("Limestone" or the "Company") respectfully submits its Response to the Consumer Advocate's Motion to Dismiss ("*Motion*"). For the reasons that follow, Limestone respectfully requests that the Commission deny the *Motion*.

I. PROCEDURAL HISTORY

Limestone filed its *Petition* for a general rate increase on July 16, 2024.[1] Among other things, in its *Petition*, the Company expressly requested "that the Commission adopt and approve ratemaking methodologies sufficient to enable implementation of an alternative ratemaking mechanism under Tennessee Code Annotated Section 65-5-103(d)(6) upon any subsequent application by Limestone Water for adoption of Annual Review Mechanism."[2] Subsequent to a contested case hearing, Chairman David F. Jones publicly submitted a Pre-filed Motion on the

[1] *Petition of Limestone Water Utility Operating Company, LLC to Increase Charges, Fees and Rates and for Approval of a General Rate Increase and Consolidated Rates*, TPUC Docket No. 24-00044 (July 16, 2024) (hereinafter "*Petition*").

[2] *Petition*, p. 7, ¶ 16.

Merits of the Limestone Rate Case on April 11, 2025. The Presiding Panel adopted Chairman Jones's pre-filed motion during deliberations on April 14, 2025, which decisions were memorialized in the Commission's July 10, 2025, Order Setting Utility Rates ("*2025 Rate Order*"). The Commission resolved the contested issues presented in the case and established the requisite ratemaking methodology required under Tenn. Code Ann. § 65-5-103(d)(6).

To alleviate the immediate impact on customers of the authorized rate increases, the Commission adopted "a rate design to recover the entire deficiency company-wide" and "determined that the overall rate increase be spread over two phases, one effective May 1, 2025, and the second effective May 1, 2026.[3] Under the two-phase approach, Limestone "should recover approximately 50% of the revenue deficiency in phase one and the remaining 50% in phase two."[4]

With respect to phase two, the Commission ordered Limestone to file updated information, including the amount of revenues collected by month by system and the latest available monthly billing determinants by system.[5] Further, the Commission "directed Limestone to file a rate design for commercial sewer customers to generate an additional $242,076 from sewer customers, representing a 63.61% increase in overall commercial sewer revenues."[6] Limestone filed revised tariffs compliant with the *2025 Rate Order* on May 19, 2026.[7]

The Company filed the information requested by the Commission with respect to phase two on March 2, 2026. Subsequent to a contested hearing on phase two, on June 1, 2026, the Presiding Panel deliberated and passed the motion submitted by Chairman David F. Jones.

[3] *2025 Rate Order* at 106.

[4] *Id*.

[5] *Id*.

[6] *Id*. at 107.

[7] *Commission Acknowledgement Receipt of Limestone Water Utility Operating Company's Tariff Filing Number 2025-0017*, TPUC Docket No. 24-00044 (May 22, 2025).

Chairman Jones' motion was filed in the public docket on June 2, 2026. Limestone filed tariffs compliant with the Commission's June 1, 2026, decision on June 5, 2026.[8] On August 4, 2026, Limestone submitted its Petition of Limestone Water Utility Operating Company, LLC to Elect and Opt Into an Annual Rate Review Mechanism and ARRM Tariff Pursuant to Tenn. Code Ann. § 65-5-103(d)(6).[9]

II. DISCUSSION & ARGUMENTS

The gravamen of the *Motion* is twofold. First, the CAD maintains that the *2025 Rate Order* did not establish the requisite ratemaking methodology necessary under the ARRM statute.[10] Second, the CAD contends that the *ARRM Petition* is premature since the Commission has not memorialized its June 1, 2026, decisions in phase two.[11] Both grounds are insufficient to warrant dismissal of Limestone's *ARRM Petition*.

a. THE CAD'S CONTENTION THAT THE COMMISSION DID NOT ESTABLISH THE REQUISITE RATEMAKING METHODOLOGIES IS WITHOUT MERIT

The Commission adopted Limestone's ratemaking methodology in its *2025 Rate Order*. The *2025 Rate Order* established the Company's ratemaking framework and prescribed the methodologies governing revenues, expenses, taxes, rate base, debt costs, reconciliation balances, and other ratemaking components. The Consumer Advocate incorrectly equates those ratemaking methodologies with subsequent proceedings addressing implementation of approved rates using updated billing determinants.[12]

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[8] *Commission Acknowledgement Receipt Letter of Limestone Water Utility Operating Company's Tariff Filing Number 2026-0024*, *Phase II*, TPUC Docket No. 24-00044 (June 8, 2026).

[9] *Petition of Limestone Water Utility Operating Company, LLC to Elect and Opt Into an Annual Rate Review Mechanism and ARRM Tariff Pursuant to Tenn. Code Ann. § 65-5-103(d)(6)*, TPUC Docket No. 26-00070 (Aug. 4, 2026) (hereinafter "*ARRM Petition*").

[10] *CAD Motion to Dismiss*, at 2, TPUC Docket No, 22-00028 (Aug. 11, 2026).

[11] *Id*.

[12] *See 2025 Rate Order* at 112, ¶ 20.

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In its *Motion*, the CAD lists examples necessary for the requisite ratemaking methodologies. The CAD's list includes depreciation and rate of return,[13] which were established in the *2025 Rate Order*. Tenn. Code Ann. § 65-5-103(d)(6)(A) requires that an ARRM "be based upon the methodology adopted in [the utility's] most recent rate case[.]" In the *2025 Rate Order*, the Commission adopted specific ratemaking treatments and calculation methodologies, including, but not limited to, the following:

- classification of Tap and Inspection Fees as revenues;
- calculation of unmanageable debt expense using a one percent allowance;
- treatment of Annual Reconciliation Balances;
- computation of state excise taxes and federal income taxes based upon adjusted revenues and expenses;
- calculation of synchronized interest using rate base and weighted cost of debt; and
- inclusion of specified reconciliation amounts within rate base.

These are not merely implementation details. Rather, they are Commission-prescribed ratemaking methodologies governing how revenues, expenses, taxes, debt costs, and rate base are determined. The Commission expressly adopted these methodologies and directed how they are to be applied in future ratemaking calculations. The methodology required by § 65-5-103(d)(6)(A) therefore has been established by the Commission. The Consumer Advocate's argument incorrectly assumes that no ratemaking methodology exists until every aspect of rate implementation is finalized. The statute contains no such requirement.

[13] *Id*. at 3.

In other words, the point of a methodology is that it is not subsumed by implementation details; it sets the process by which those details will be generated. The subsequent phase two proceeding concerning billing determinants does not negate the methodologies already adopted by the Commission. The statute requires an adopted methodology. It does not require that every future implementation matter be resolved before a utility may elect to an ARRM.

CAD's reliance on the Atmos Energy decision in TPUC Docket No. 14-00081 underscores the inherent flaws of the *Motion*. In that case, Atmos Energy sought an ARRM based on the Commission's approval of negotiated rates. The underlying rates in the Atmos Energy case were established pursuant to a settlement agreement that expressly disclaimed any agreement regarding *ratemaking methodology, accounting methodology, cost allocation methodology, and revenue-*related methodology. The settlement further stated that it was not intended to establish precedent for future proceedings.[14]

Limestone, on the other hand, seeks an ARRM based on ratemaking methodologies established by the Commission in a contested case. Unlike the Atmos decision, Limestone's rates were established through a litigated rate proceeding culminating in a Commission-issued decision, in which the Commission adopted specific ratemaking methodologies governing the calculation of revenues, expenses, taxes, debt costs, annual reconciliation balances, and rate base. The Commission further established the operating margin framework and associated ratemaking adjustments to be used in determining rates.

The CAD's *Motion* should be denied because the *2025 Rate Order* clearly established the ratemaking methodologies required to opt into an ARRM.

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[14] *Order Approving Settlement Agreement*, TPUC Docket No. 12-000064 (Dec. 4, 2012).

b. THE CAD'S POSITION THAT THE ABSENCE OF A PHASE TWO ORDER PROHIBITS LIMESTONE FROM SEEKING AN ARRM IS BOTH MISPLACED AND CONTRARY TO TENNESSEE LAW

The CAD's argument regarding the absence of a phase two order conflates ratemaking methodology with the application of that methodology. Even assuming for the sake of argument that a phase two written decision is necessary to somehow affirm again the ratemaking methodologies already established in the *2025 Rate Order*, the courts have long-established that specific findings of fact and conclusions of law in the record satisfy the requirements for a written decision.[15] In addition to the prevailing motion publicly filed in the case regarding phase two, the transcript, as the courts have declared, provides the necessary record.

The Commission's *2025 Rate Order* established the ratemaking framework used to determine the revenue requirement and rates. The subsequent phase two proceeding did not establish a new ratemaking methodology. Rather, it applied the already-approved framework using updated customer and billing information. The rate design methodology itself remained unchanged. The need for updated determinants does not mean the underlying methodology was unresolved. Utilities routinely apply approved methodologies using updated customer, usage, and billing information without reopening the underlying ratemaking framework.

III. CONCLUSION

The Consumer Advocate's *Motion* improperly treats implementation issues concerning updated billing determinants as though they were unresolved questions of ratemaking methodology, which they simply are not. Pursuant to the *2025 Rate Order*, Limestone's *ARRM Petition* is neither premature nor procedurally defective. For the foregoing reasons, Limestone respectfully requests that the Commission deny the Consumer Advocate's *Motion* in its entirety.

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[15] *See, e.g., B&W Pipeline, LLC v. Tenn. Reg. Auth.*, 2017 WL 513977 *9 (Aug. 24, 2017) (attached hereto); and *Consumer Adv. Div. v. Tenn. Reg. Auth.*, 1998 WL 684536 *3 (Tenn. Ct. App. July 1, 1998) (attached hereto).

Along more pragmatic lines, and due to the unique circumstances presented, Limestone voluntarily requests that the Commission suspend Limestone's ARRM Petition until September 21, 2026.[16] Although the courts have opined that Commission deliberations in the record that include specific findings of fact and conclusions of law satisfy the statutory requirements for a written decision, this good faith voluntary tolling would provide additional time for the Commission to memorialize its decisions from the June 1, 2026, deliberations in TPUC Docket No. 24-00044, which would moot the *Motion*.

Respectfully Submitted,

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[16] Should the Commission accept Limestone's voluntary suspension of its *ARRM Petition* until September 21, 2026, Limestone will voluntarily agree to a decision on its *ARRM Petition* on the merits by the Commission on or before January 19, 2027.

CERTIFICATE OF SERVICE

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

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This the 19th day of August, 2026.

Melvin Malone

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2017 WL 5135977

SEE COURT OF APPEALS RULES 11 AND 12
Court of Appeals of Tennessee,
AT NASHVILLE.

B&W PIPELINE, LLC
v.
TENNESSEE REGULATORY AUTHORITY, et al.

No. M2016–02013–COA–R12–CV
|
August 24, 2017 Session
|
FILED 11/06/2017

Appeal from the Tennessee Regulatory Authority, No. 15–00042

Attorneys and Law Firms

Patricia Head Moskal and Henry M. Walker, Nashville, Tennessee, for the appellant, B&W Pipeline, LLC.

Kelly Cashman–Grams and Ryan McGehee, Nashville, Tennessee, for the appellee, Tennessee Regulatory Authority.

Herbert H. Slatery, III, Attorney General and Reporter; Andrée Blumstein, Solicitor General; Vance L. Broemel, Senior Counsel; and Daniel P. Whitaker, III, Assistant Attorney General, for the appellee, the Consumer Protection and Advocate Division Office of the Tennessee Attorney General.

Thomas R. Frierson, II, J., delivered the opinion of the court, in which D. Michael Swiney, C.J., and W. Neal McBrayer, J., joined.

OPINION

Thomas R. Frierson, II, J.

B&W Pipeline, LLC ("B&W"), a public utility that owns a gas pipeline in three Tennessee counties, filed a petition with the Tennessee Regulatory Authority [1] ("the Authority") seeking a rate increase. As part of the rate increase request, B&W sought to include in the rate base $2.6 million in acquisition costs that it had incurred when it purchased the pipeline and several oil and gas wells in 2010. A contested case hearing took place on September 14, 2015. Following deliberation, the Authority denied B&W's proposed acquisition adjustment and instead utilized a 2008 federal income tax return filed by the pipeline's previous owner to establish the pipeline's value for the purpose of determining the rate base. The Authority issued its final order on March 10, 2016. B&W timely filed a motion for reconsideration. The Authority denied the motion for reconsideration with respect to the value of the pipeline while granting the motion for reconsideration with respect to certain due diligence and other costs B&W incurred in the acquisition. After the submission of briefs, the Authority affirmed its decision to exclude the additional acquisition costs. The Authority issued a final order concerning reconsideration on August 4, 2016. B&W filed a timely petition for review with this Court on October 3, 2016. Discerning no error, we affirm the Authority's decision.

I. Factual and Procedural Background

***1** B&W is a public utility that owns a natural gas pipeline located in parts of Pickett, Morgan, and Fentress counties in Tennessee. The pipeline was originally built in the 1980s. The pipeline has one primary customer for regulated service, Navitas TN NG LLC ("Navitas"). B&W delivers natural gas to Navitas, which, in turn, distributes gas to a number of residential and commercial customers in Tennessee and Kentucky.

Prior to 2010, the pipeline and the distribution system were both owned and operated by Gasco Distribution Systems, Inc. ("Gasco"). As part of Gasco, the pipeline operated pursuant to Gasco's certificate of convenience and necessity ("CCN"), granted by the Authority. In 2010, Gasco, while in bankruptcy, sold the local distribution system to Navitas, and Gasco's CCN was transferred to Navitas. Gasco subsequently sold the pipeline and ninety-six oil and gas wells to Highland Rim Energy, B&W's parent company, for $2,633,085.00. The pipeline and wells were later assigned to B&W. B&W presented testimony that the pipeline and wells, many of which were inactive, were a "package deal," such that B&W was "stuck with the wells."

Following its purchase of the pipeline, B&W continued providing gas to Navitas at the rate of $.60 per Mcf, [2] according to a pre-existing contract. A representative for B&W testified that two to three years following the purchase of the pipeline, the Authority informed B&W that the pipeline had to be regulated. The Authority granted B&W a CCN on January 8, 2015. B&W filed a petition to increase rates with the Authority on April 2, 2015, following expiration of the aforementioned contract. B&W sought to increase its rates from $.60 per Mcf to $3.69 per Mcf, representing a significant rate increase. Both Navitas and the Consumer Protection and Advocate Division of the Office of the Tennessee Attorney General ("Consumer Advocate") were allowed to intervene and oppose the rate increase, and the Authority opened a contested case proceeding.

In its petition, B&W combined the purchase price of the pipeline and gas and oil wells, as well as certain acquisition costs, such as due diligence costs, into the proposed rate base. B&W argued that it should be allowed to charge a rate that covered its expenses, including depreciation, and that allowed B&W to earn a reasonable rate of return on its investment in physical assets. The parties engaged in discovery prior to the hearing, which was scheduled for September 2015. During discovery, B&W stated that it had no records from the prior owner disclosing the original cost of the pipeline.

On August 11, 2015, the Consumer Advocate and Navitas submitted pre-filed testimony in opposition to the proposed rate increase, including the proposed value of the pipeline for rate-making purposes. The Consumer Advocate's witness, Ralph Smith, asserted that the rate base should not include the acquisition costs of the pipeline in 2010 but that it should include only the original pipeline cost minus depreciation pursuant to the Uniform System of Accounts, which the Authority required B&W to utilize. B&W submitted pre-filed rebuttal testimony, wherein B&W's witness, William Novak, contended that the investment made in purchasing the pipeline and wells, totaling over $2.6 million, should be included in the rate base as a reasonable "estimate" of the original cost of the pipeline.[3] In response to a request from the Authority seeking additional information concerning the value of the pipeline, on September 8, 2015, Navitas submitted a 2008 federal income tax return filed by Gasco.

***2** The contested case hearing took place before the Authority on September 14, 2015. During the hearing, the Consumer Advocate submitted the 2008 Gasco tax return as evidence with no objection from B&W. Mr. Smith, on behalf of the Consumer Advocate, testified that the 2008 Gasco tax return was the most reliable information regarding the pipeline's depreciated original cost. This tax return listed depreciable assets of $854,826.00 and reported depreciation for that year in the amount of $22,564.00. Mr. Smith opined that the pipeline had thus been almost fully depreciated by the time of the hearing. Mr. Novak opined that tax return information relied upon by Mr. Smith was actually referring to the oil and gas wells rather than the pipeline. At the conclusion of the hearing, B&W's counsel acknowledged that "no clear evidence of what the rate base ought to be" existed and that the issue was one of "policy and fairness."

On November 16, 2015, the hearing officer issued an order indicating that the parties had informed him that they "d[id] not seek additional argument, evidence, or new cross-examination of any evidence." No new evidence was thereafter filed by either party. On December 14, 2015, the Authority deliberated and set rates. As part of its ruling, the Authority rejected B&W's position that the 2010 purchase price of $2.6 million for the pipeline and wells should be included in the rate base. Instead, the Authority utilized the 2008 Gasco tax return, determining it to be the "most sound support for the prior owner's original cost and the value of the pipeline at the time of acquisition." Based on the information contained in the tax return, the Authority concluded that the original cost of the pipeline had been almost fully depreciated by the time of the 2015 rate hearing.

Following issuance of the Authority's order setting rates, B&W filed a timely motion for reconsideration. In this motion, B&W claimed that assigning a value of $1.2 million to $1.6 million to the pipeline would equitably balance the interests of the parties. B&W attached new documents, including a non-notarized affidavit of a prior president of Gasco and additional Gasco tax documentation, for the Authority to consider as additional evidence with respect to the value of the pipeline. B&W also argued in the motion that the Authority had erred by failing to include related acquisition costs of $225,585.31 in the rate base calculation.

In an order dated May 16, 2016, the Authority declined to grant reconsideration with respect to the value of the pipeline, determining that the issue had been fully litigated during the hearing on the merits and that no good cause was presented to justify B&W's failure to introduce the additional evidence during the original proceeding. The Authority did, however, grant reconsideration regarding the issue of acquisition costs, directing the hearing officer to schedule arguments addressing this issue. Subsequently, on August 4, 2016, the Authority denied the inclusion of such acquisition costs in the rate base, determining that such costs had been included in the $2.6 million dollar purchase price previously rejected by the

Authority. B&W filed a timely petition for review with this Court.

II. Issues Presented

B&W presents the following issues for our review, which we have restated slightly:

1. Whether the Authority acted in an arbitrary and capricious fashion when it refused to include in the rate base the acquisition price paid for the pipeline by B&W in 2010.

2. Whether the Authority abused its discretion by denying B&W's petition for reconsideration with respect to the value of the pipeline.

3. Whether the Authority's final order fails to comply with the requirements of Tennessee Code Annotated § 4–5–314(c) because it contains no findings of fact or conclusions of law with regard to the acquisition costs.

III. Standard of Review

This Court's review of the Authority's decision is governed by Tennessee Code Annotated § 4–5–322(h) (Supp. 2017). *See Consumer Advocate Div. ex rel. Tenn. Consumers v. Tenn. Regulatory Auth.*, No. M1999–01170–COA–R12–CV, 2001 WL 575570, at *3 (Tenn. Ct. App. May 30, 2001). Tennessee Code Annotated § 4–5–322(h) provides:

> ***3** The court may affirm the decision of the agency or remand the case for further proceedings. The court may reverse or modify the decision if the rights of the petitioner have been prejudiced because the administrative findings, inferences, conclusions or decisions are:
>
> (1) In violation of constitutional or statutory provisions;
>
> (2) In excess of the statutory authority of the agency;
>
> (3) Made upon unlawful procedure;
>
> (4) Arbitrary or capricious or characterized by abuse of discretion or clearly unwarranted exercise of discretion; or
>
> (5)(A) Unsupported by evidence that is both substantial and material in the light of the entire record.
>
> (B) In determining the substantiality of evidence, the court shall take into account whatever in the record fairly detracts from its weight, but the court shall not substitute its judgment for that of the agency as to the weight of the evidence on questions of fact.

The review by this Court is for the "very limited purpose of determining whether the [Authority] has acted arbitrarily, or in excess of its jurisdiction, or otherwise unlawfully." *Consumer Advocate & Prot. Div. of Office of Atty. Gen. v. Tenn. Regulatory Auth.*, No. M2011–00028–COA–R12–CV, 2012 WL 1964593, at *13 (Tenn. Ct. App. May 30, 2012) (quoting *CF Indus. v. Tenn. Pub. Serv. Comm'n*, 599 S.W.2d 536, 540 (Tenn. 1980)) (in turn quoting *City of Whitwell v. Fowler*, 343 S.W.2d 897, 899 (Tenn. 1961)). Such issues are reviewed *de novo* based upon the Authority's record. *See Consumer Advocate & Prot. Div. of Office of Atty. Gen.*, 2012 WL 1964593, at *13. As this Court has further explained:

> [I]n reviewing an administrative decision, a court "shall not substitute its judgment for that of the agency as to the weight of the evidence on questions of fact." T.C.A. § 4–5–322(h)(5); *Humana of Tennessee v. Tennessee Health Facilities Comm'n*, 551 S.W.2d 664 (Tenn. 1977). Factual issues are reviewed upon a standard of substantial and material evidence, and not upon a broad, *de novo* review. *Southern Ry. Co. v. State Bd. of Equalization*, 682 S.W.2d 196, 199 (Tenn. 1984) (citing *CF Indus. v. Tennessee Pub. Serv. Comm'n,* 599 S.W.2d 536, 540 (Tenn. 1980)). Substantial and material evidence is " 'such relevant evidence as a reasonable mind might accept to support a rational conclusion and such as to furnish a reasonably sound basis for the action under consideration.' " *Sweet v. State Tech. Inst. at Memphis,* 617 S.W.2d 158, 161 (Tenn. App. 1981) (quoting *Pace v. Garbage Disposal Dist. of Washington County,* 54 Tenn. App. 263, 390 S.W.2d 461, 463 (1965)). It is "something less than a preponderance of the evidence, but more than a scintilla or glimmer." *Wayne County v. Tennessee Solid Waste Disposal Control Bd.,* 756 S.W.2d 274, 280 (Tenn. App. 1988). A court will not disturb a reasonable decision of an agency with expertise, experience, and knowledge in the appropriate field. *Southern Ry. Co.,* 682 S.W.2d at 199.

In re All Assessments, No. 01A01–9812–BC–00642, 1999 WL 632824, at *4 (Tenn. Ct. App. Aug. 20, 1999).

IV. Fixing Just and Reasonable Rates: Original Cost versus Acquisition Cost

The Authority "has the power ... to fix just and reasonable individual rates, joint rates, tolls, fares, charges or schedules thereof ...." Tenn. Code Ann. § 65–5–101(a) (2015). Additionally, Tennessee Code Annotated § 65–5–103 (2015) states in pertinent part:

> ***4** (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 authority 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 authority shall take into account the safety, adequacy and efficiency or lack thereof of the service or services furnished by the public utility.

With regard to utility rates, this Court has previously explained:

> The utility is permitted to set base rates that allow it to recover its operating expenses and earn a profit from the consumer from the operation of its business; in overseeing these base rates, the TRA is required to balance the interests of the utility with the interests of Tennessee consumers. *See Tenn. Am. Water Co. v. Tenn. Reg. Auth.,* No. M2009–00553–COA–R12–CV, 2011 WL 334678, at *15 (Tenn. Ct. App. Jan. 28, 2011). On one hand, the rate approved by the TRA must provide the utility the opportunity to earn a just and reasonable return on its investment; on the other hand the rate must not be exorbitant, so as to avoid the exploitation of consumers. *See Bluefield Water Works & Improvement Co. v. Public Serv. Comm'n of the State of West Va.,* 262 U.S. 679, 690, 43 S. Ct. 675, 67 L.Ed. 1176 (1923). "A rate need only fall within the 'zone of reasonableness' ... that takes into consideration the interests of both the consumer and the utility." *Tenn. Cable Television Ass'n. v. Tenn. Pub. Serv. Comm'n,* 844 S.W.2d 151, 159 (Tenn. Ct. App. 1992).

Consumer Advocate & Prot. Div. of Office of Atty. Gen., 2012 WL 1964593, at *1.

In the instant action, the Authority in its order similarly explained the criteria utilized to set "just and reasonable rates" as follows:

> In setting rates for public utilities, the Authority balances the interests of the utilities subject to its jurisdiction with the interests of Tennessee consumers, i.e., it is obligated to fix just and reasonable rates. The Authority must also approve rates that provide regulated utilities the opportunity to earn a just and reasonable return on their investments. The Authority considers petitions for a rate increase, filed pursuant to Tenn. Code Ann. § 65–5–[1]03, in light of the following criteria:
>
> 1. The investment or rate base upon which the utility should be permitted to earn a fair rate of return;
> 2. The proper level of revenues for the utility;
> 3. The proper level of expenses for the utility; and
> 4. The rate of return the utility should earn.

As the Authority also explained in its order, "[t]he primary contested issue concerning rate base centered on whether to allow the inclusion of B&W's acquisition cost of $2,633,085 in rate base calculations, as proposed by [B&W]." With regard to this issue, the Authority made the following extensive findings:

> B&W acquired the pipeline and ninety-six (96) oil and natural gas wells for $2,633,085 from Gasco's bankruptcy proceeding in 2010. [B&W] had no records for the net book value of the pipeline, but rather recorded the acquisition price as plant in service. According to [B&W], because the seller would not sever the pipeline from the wells, B&W had to take the wells in order to get the pipeline; therefore B&W assigned none of the acquisition cost to the wells. B&W estimated the value of the producing wells to be $60,943 and the net liability of capping the inactive wells to be $29,845.

* * *

B&W believes it made a good business decision in purchasing the pipeline for $2.6 million because it is less than the cost to build one. Mr. Ramon further testified that [B&W] became aware after the purchase that approximately 40 to 50 of the wells had already been plugged or handed over to the landowners. Further, only thirteen (13) of the wells are currently producing oil or gas.

***5** In addition, [B&W] supported its acquisition cost with an independent analysis performed by Bell Engineering. The Bell analysis estimates the 2013 replacement cost of the pipeline to be $12,885,858 and the undepreciated costs are $6,559,308, which far exceeds the acquisition cost included in rate base. Even if this amount is depreciated back to the pipeline's construction date, its replacement value still exceeds the amount included in rate base....

Navitas noted that 100% of the purchase price is attributed in B&W's rate case to the pipeline although other assets, including wells, were included in the transaction. Mr. Hartline asserts that there is no sound economic basis for spending $2 million on a pipeline that earns $20,000 annually. Therefore, a substantial portion of the purchase price is and should be attributed to the other assets purchased in the transaction. Mr. Hartline testified that the Bell Engineering report was an inappropriate basis to support inclusion of the acquisition costs as replacing the pipeline today would be uneconomic in the rural area the pipeline services.

In the pre-filed testimony of Mr. Smith, the Consumer Advocate proposed to exclude from Plant in Service the pipeline purchase costs and, instead, treat it as an Acquisition Adjustment because B&W failed to provide reliable information on the original cost of the pipeline. Mr. Smith explains that any amount paid for utility plant in excess of the utility's original costs are referred to as “Goodwill” or Acquisition Premium, and not allowed recovery in rates because it is not used or useful in the provision of utility service. Disallowance of Goodwill or Acquisition Premium discourages companies from marking up the cost of assets used to provide utility service through the transfer or selling to different owners. Mr. Smith states that B&W was unable to provide the original cost, and the pipeline cost was not available from the books of Gasco (the seller) or the property tax information on file for Gasco. He determined from the responses to data requests that B&W did acquire 96 oil and gas wells along with the pipeline and that B&W determined the net value of these wells to be a negative $29,845 due to the cost of capping inactive wells. Therefore, none of [the] purchase price was assigned by B&W to the wells.

From B&W's 2012 trial balance, Mr. Smith ascertained that there was a gross profit of $182,582, which included $19,729 for gas transportation and $162,853 from oil and gas sales and royalties. Thus, according to Mr. Smith, of the revenues generated by the pipeline, 11% were from transportation service and 89% from oil and gas sales and royalties. The wells in question have since been transferred to a B&W affiliate, Rugby Energy, LLC, and are operated by another affiliate, Enrema, which is the same affiliate charging B&W an annual operator fee. Because of the gross profit in 2012 and the transfer taking place between two affiliates with the same ownership, Mr. Smith questions the lack of compensation for the wells. For these reasons, the Consumer Advocate removed the acquisition amount of $2,597,285 from Plant in Service and left only the $437,715 as the cost of the pipeline. This represents the amount spent by B&W for safety improvements after B&W acquired the pipeline. Removing this amount from Plant in Service results in a reduction of the attrition year mid-point accumulated depreciation by $568,367 for a total rate base reduction of $2,028,918 related to the cost of the pipeline.

***6** In response to data requests from Authority Staff, Navitas provided records from the previous owner of the pipeline, including a 2008 tax return. During the hearing, Mr. Smith addressed the 2008 federal income tax return, stating that the reported pipeline assets at the end of 2008 were $854,926 as plant-depreciable assets. The tax return reported accumulated depreciation of $703,017 as of December 31 st, 2008 and a land asset reported in the amount of $68,538. The reported tax year depreciation was $22,564, which is representative of a depreciable life of approximately 38 to 40 years; reasonable for a gas pipeline. Mr. Smith points out the return was prepared by a CPA and signed by an officer of the Company and as such, appeared to be the most reasonable and reliable information available on the value of the pipeline.

With respect to Gasco's 2008 tax return, Mr. Novak responded that the affiliate IRS PBA code listed is for mineral extraction. Therefore the return is not really applicable in this case because it does not represent a value for the pipeline. Rather it represents a value for the oil and gas wells. Mr. Smith was cross-examined regarding the

> IRS PBA codes noted by Mr. Novak. Mr. Smith noted that Schedule L of the return lists these as depletable assets, and a pipeline or building should be classified as depreciable assets. Therefore, the tax return is applicable and if one carries the amount out through the midpoint of the attrition year, it would be almost zero ($17,182) as the Consumer Advocate proposed. Mr. Smith agrees that either zero or $17,182 would be an acceptable cost of the pipeline at the midpoint of the 2016 attrition year.
>
> Mr. Novak asserts that the Consumer Advocate has ignored the data provided by [B&W] and the State of Tennessee's tax assessment of the pipeline when he disallows the acquisition cost of the pipeline in his analysis. The tax assessment relied upon by the Company reported to the State of Tennessee as the cost of the pipeline in exact and equal amounts in each county the pipeline operates within, which Mr. Smith questions. Mr. Smith points out that the previous owner had a total assessment of $756,000, with $976 assessed in Fentress County, $227,660 in Pickett County and the remainder in Campbell County, including Jellico. Mr. Smith notes that the tax assessment is prepared by the Company and requires information regarding B&W's last rate case. In sum, the Consumer Advocate contends that the tax assessment relied upon by the Company is an unreasonable basis to support the inclusion of the acquisition price in rate base.
>
> * * *
>
> There is no persuasive evidence that suggests that including the entire purchase price is in the public interest. Under the circumstances of this case, the most reasonable determination is based upon information that is related to the actual cost of the plant when it was constructed. Based on the evidence in the proceeding, the panel finds that including the pipeline at the original cost, rather than the acquisition cost, is the solution that is most fair to both customers and B&W.
>
> The panel further finds that the 2008 tax return of Gasco Distribution Systems, Inc. and Subsidiaries provides the most sound support for the prior owner's original cost and the value of the pipeline at the time of acquisition. Therefore, the panel concludes that B&W's Plant in Service include $923,364 as the original cost of the pipeline, which includes the prior owner's original cost of plant of $854,826 and land of $68,538. Further, including $923,364 as the original cost of the pipeline, along with $437,715 of uncontested additions since B&W's acquisition, as well as uncontested land, structures and intangible property of $119,842, results in total Plant in Service of $1,480,921. Finally, the panel further adopts Accumulated Depreciation of $919,975 which includes accumulated depreciation of $854,826 related to the original pipeline acquired by B&W and $65,149 of accumulated depreciation related to the new additions.

***7** (Footnotes omitted).

B&W argues that the rate base set by the Authority was unjust, due to the Authority's reliance upon "a document that was misinterpreted, which led the Authority to understate the value of the pipeline." B&W contends that the Authority abused its discretion by accepting the depreciated "tax value" of the pipeline rather than its "book" value. B&W further contends that the Authority's decision was not supported by substantial and material evidence. We disagree.

This Court "shall not substitute its judgment for that of the agency as to the weight of the evidence on questions of fact." *See In re All Assessments*, 1999 WL 632824, at *4 (quoting Tenn. Code Ann. § 4–5–322(h)(5)). Factual issues are reviewed upon a standard of substantial and material evidence, which this Court has defined as " 'such relevant evidence as a reasonable mind might accept to support a rational conclusion and such as to furnish a reasonably sound basis for the action under consideration.' " *See In re All Assessments*, 1999 WL 632824, at *4 (quoting *Sweet v. State Tech. Inst. at Memphis,* 617 S.W.2d 158, 161 (Tenn. App. 1981)) (in turn quoting *Pace v. Garbage Disposal Dist. of Washington Cty.*, 54 Tenn. App. 263, 390 S.W.2d 461, 463 (1965)). This Court will not disturb a reasonable decision of an agency with "expertise, experience, and knowledge in the appropriate field." *See In re All Assessments*, 1999 WL 632824, at *4.

The Authority's decision to exclude the $2.6 million purchase price of the pipeline and wells from the rate base was supported by substantial and material evidence. Mr. Smith testified at length regarding his interpretation of the 2008 Gasco tax return, which was the only evidence presented regarding the prior owner's cost or valuation. Mr. Smith explained that the tax return showed $854,926.00 as plant/ depreciable assets, which he opined could only refer to the pipeline because oil and gas wells constituted depletable rather than depreciable assets. Mr. Smith further explained that the amount of depreciation shown on the return, $22,564.00, was in accordance with a thirty-eight to forty-year depreciation schedule, which would be reasonable for a pipeline. Mr. Smith opined that the 2008 tax return was the most reliable information concerning the prior owner's assessment of value and that its reliability was further supported by its preparation by a certified public accountant and submission to the IRS. Based on this proof, we determine that the Authority's decision was based on evidence that is "both substantial and material in the light of the entire record." *See* Tenn. Code Ann. § 4–5–322(h).

Moreover, the Authority's determination to rely upon original cost information aligns with other rate base decisions. For example, in a factually similar case, the Authority held:

> [T]he commission finds that the book value of the Franklin system at the time of the United Cities acquisition should be based on the original cost figures developed by Mr. Crenshaw and approved by the comptroller in 1973 rather than on the much higher estimate arrived at by the company's witness more than ten years later. The customers of the Franklin system have paid once for the system's assets; to accept the company's argument that the cost of those assets has now doubled would force ratepayers to pay once again for these same assets.
>
> ***8** Company witness Fleming recognized the danger to ratepayers of permitting a gas utility to write up the value of its assets above their book value, and readily acknowledged that "as everyone is well aware, this commission generally allows the original costs of utility facilities in rate base." He noted that the reason why regulatory commissions insist on using original cost "is to keep people from double paying, in effect, artificially inflating the rate base" as the result of purchasing assets at a price higher than book value.

See *Re: United Cities Gas Co.*, No. U–84–7333, 1985 WL 1213311 (Tenn. P.S.C. June 10, 1985) (footnote omitted). *See also* *In Re: Petition of Chattanooga Gas Co. to Place into Effect A Revised Natural Gas Tariff*, No. 97–00982, 1998 WL 35628746 (Tenn. P.S.C. Oct. 7, 1998) (rejecting the utility's request to include acquisition costs in rate base upon determining that additional benefit to customers came from subsequent investments in plant system that were already incorporated into rate base).

As the Authority also noted in this action, B&W's acquisition cost included oil and gas wells. Testimony demonstrated that a significant portion of the income generated by B&W in the past came from oil and gas sales rather than pipeline operations. Testimony further demonstrated that rather than purchasing the pipeline and wells to maintain the status quo with regard to operations, B&W administrators hoped to utilize the pipeline for other uses in the future that may or may not involve providing utility service. For the foregoing reasons, we conclude that the Authority's determination regarding rate base should be affirmed.

IV. Denial of Petition to Reconsider Pipeline Value

B&W alleges that the Authority abused its discretion by denying B&W's petition to reconsider the valuation of the pipeline and thus refusing to consider the new evidence presented by B&W with its petition. With regard to a petition for reconsideration, the Uniform Administrative Procedures Act states:

> (a) Any party, within fifteen (15) days after entry of an initial or final order, may file a petition for reconsideration, stating the specific grounds upon which relief is requested. However, the filing of the petition shall not be a prerequisite for seeking administrative or judicial review.
>
> * * *
>
> (d) An order granting the petition and setting the matter for further proceedings shall state the extent and scope of the proceedings, which shall be limited to argument upon the existing record, and <u>no new evidence shall be introduced unless the party proposing such evidence shows good cause for such party's failure to introduce the evidence in the original proceeding</u>.

Tenn. Code Ann. § 4–5–317 (2015) (emphasis added).

In its petition, B&W argued that the 2008 Gasco tax return had been misinterpreted by the Authority. B&W stated that it had located the former president of Gasco, Fred Steele, who had in turn located and provided the depreciation schedules and other tax information for Titan Energy, a subsidiary of Gasco that owned the pipeline prior to B&W's purchase. Mr. Steele's unsworn affidavit and the additional tax information were attached to B&W's petition. B&W asserted that this additional tax information demonstrated that the pipeline had been depreciated at an accelerated rate for tax purposes over a period of seven years. According to B&W, this tax information also demonstrated that the sale of the pipeline was recorded in 2010 at a value of $1,212,892.80. Importantly, however, B&W's petition failed to contain any information concerning good cause for B&W's failure to present this evidence at the original hearing, as required by Tennessee Code Annotated § 4–5–317(d).

***9** As the Authority points out, B&W had ample opportunity during the contested case hearing and for approximately sixty days thereafter to present any necessary evidence to meet its burden of proof, but B&W chose not to present additional evidence until after the Authority ruled. Because B&W failed to demonstrate good cause why this evidence could not have been presented earlier, we conclude that the Authority did not abuse its discretion by declining to consider the additional evidence. *See* Tenn. Code Ann. § 4–5–317(d). *See, e.g.*, *Pavement Restorations Inc. v. Ralls*, No. W2016–01179–COA–R3–CV, 2017 WL 657775, at *8 (Tenn. Ct. App. Feb. 17, 2017) ("The refusal [by an administrative agency] ... to grant a rehearing will not be found to be arbitrary or capricious unless the appellant can 'show specifically why [the appellant] was unable to procure the "newly discovered" evidence and that [the appellant] exercised due diligence in attempting to obtain the evidence prior to' the hearing.") (quoting *Bridges v. Culpepper*, No. 02A01–9704–CH–00074, 1997 WL 589242, at *4 (Tenn. Ct. App. Sept. 24, 1997)) (in turn quoting *Brown v. Weik*, 725 S.W.2d 938, 947 (Tenn. App. Oct. 3, 1983)). *See also* Tenn. Code Ann. § 65–2–116 (providing that a petition for rehearing before the Authority can be maintained where new evidence is discovered "which could not have been previously discovered by due diligence.").

V. Requirements of Tennessee Code Annotated § 4–5–314(c)

Finally, B&W argues that the Authority failed to make sufficient findings of fact and conclusions of law regarding its exclusion of B&W's related acquisition costs in the amount of $225,585.31 from the rate base. As B&W points out, the Uniform Administrative Procedures Act requires the following, in relevant part, with regard to a decision of the Authority:

> (c) A final order, initial order or decision ... shall include conclusions of law, the policy reasons therefor, and findings of fact for all aspects of the order, including the remedy prescribed .... Findings of fact, if set forth in language that is no more than mere repetition or paraphrase of the relevant provision of law, shall be accompanied by a concise and explicit statement of the underlying facts of record to support the findings. The final order ... must also include a statement of the available procedures and time limits for seeking reconsideration or other administrative relief and the time limits for seeking judicial review of the final order.

Tenn. Code Ann. § 4–5–314 (2015). Additionally, Tennessee's statutory scheme specifically applicable to proceedings before the Authority provides:

> Every final decision or order rendered by the authority in a contested case shall be in writing, or stated in the record, and shall contain a statement of the findings of fact and conclusions of law upon which the decision of the authority is based. Copies of such decisions or orders shall be delivered or mailed to each party or to the party's attorney of record.

Tenn. Code Ann. § 65–2–112 (2015).

In the case at bar, B&W alleges that the Authority failed to make specific findings of fact regarding the related acquisition costs. We disagree. The Authority specifically held in its order upon reconsideration:

> B&W included the acquisition costs of $225,585.31 as part of the purchase price of $2.6 million as part of [B&W's] proposed rate base. The Authority previously set rates in a decision which rejected the purchase price of the system put forth by [B&W] and included the acquisition costs of $225,585.31 at issue upon reconsideration. By rejecting [B&W's] proposal to establish rates based on

> the purchase price, the Authority also tacitly rejected the acquisition costs related to the purchase. After reviewing and reconsidering the record, the panel found that the Authority made its decision based on the best evidence it had before it and voted unanimously to affirm its decision.

As this Court has previously explained:

> An agency, when issuing a final order, must provide a concise and explicit statement of the underlying facts supporting the agency's findings. Tenn. Code Ann. § 4–5–314(c). Findings of fact made by the agency should be based exclusively on the evidence of the record and on matters noted in the proceeding. Tenn. Code Ann. § 4–5–314(d). Exactness in form and procedure is not required; rather, the findings based on the evidence need only be specific and definite enough so that a reviewing court may determine the pertinent questions of law and whether the agency's general findings should stand, particularly when the findings are material facts at issue. *See Levy v. State of Tennessee Bd. Of Exam'rs for Speech Pathology and Audiology,* 553 S.W.2d 909, 911–12 (Tenn. 1977) (quoting *State Bd. of Med. Exam'rs v. Grandy,* 149 S.E.2d 644, 646 (S.C. 1966)). "The sufficiency of an agency's findings of fact must be measured against the nature of the controversy and the intensity of the factual dispute." *CF Industries v. Tennessee Pub. Serv. Comm'n,* 599 S.W.2d 536, 541 (Tenn. 1980).

***10** *Consumer Advocate Div. ex rel. Tenn. Consumers*, 2001 WL 575570, at *4 (emphasis added).

In this matter, the Authority clarified that its rejection of the related costs stemmed from its decision to exclude the overall acquisition costs of $2.6 million, and the reasons for such exclusion were explained in great detail in the Authority's earlier order setting rates, as set forth above. We conclude that the Authority made sufficient factual findings to facilitate this Court's review. We therefore determine this issue to be without merit.

VI. Conclusion

For the foregoing reasons, we affirm the Authority's decision in all respects. Costs on appeal are taxed to the appellant, B&W Pipeline, LLC. This case is remanded to the Authority for enforcement of the judgment below.

All Citations

Not Reported in S.W. Rptr., 2017 WL 5135977, Util. L. Rep. P 27,420

Footnotes

1 Effective April 4, 2017, the Tennessee Regulatory Authority was renamed the Tennessee Public Service Commission. *See* 2017 Tenn. Pub. Acts Ch. 94 (S.B. 747). Because this name change occurred during the pendency of this appeal and after submission of the appellant's initial brief, we will continue to utilize the moniker, Tennessee Regulatory Authority, for purposes of this appeal.

2 This is the abbreviation for one thousand cubic feet of natural gas.

3 Both Mr. Smith and Mr. Novak are certified public accountants.

1998 WL 684536

SEE COURT OF APPEALS RULES 11 AND 12
Court of Appeals of Tennessee.

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

No. 01A01-9708-BC-00391.
|
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. [1] 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:

> ***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.

599 S.W. at 542.

* * *

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.

All Citations

Not Reported in S.W.2d, 1998 WL 684536, Util. L. Rep. P 26,665

Footnotes

1 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.