

CONSUMER ADVOCATE DIVISION, )  
Office of the Attorney General )  
State of Tennessee, )  
) )  
Petitioner/Appellant, )  
) )  
VS. )  
) )  
KEITH BISSELL, CHAIRMAN; )  
STEVE HEWLETT, COMMISSIONER; )  
SARA KYLE, COMMISSIONER; )  
Constituting the Tennessee Public )  
Service Commission, )  
) )  
Respondents/Appellees. )

Appeal No.  
01-A-01-9601-BC-00049

Public Service Commission  
No. 94-04283

<p><b>FILED</b></p> <p><b>August 28, 1996</b></p> <p><b>Cecil W. Crowson</b>  <b>Appellate Court Clerk</b></p>
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COURT OF APPEALS OF TENNESSEE  
MIDDLE SECTION AT NASHVILLE

APPEALED FROM THE PUBLIC SERVICE COMMISSION  
AT NASHVILLE, TENNESSEE

FOR PETITIONER/APPELLANT: \_\_\_\_\_ FOR  
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AFFIRMED AND REMANDED

BEN H. CANTRELL, JUDGE

CONCUR:  
LEWIS, J.  
KOCH, J.

## OPINION

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.<sup>1</sup> The first section of that chapter provided:

The commission has the power after hearing upon notice, by order in writing, to fix just and reasonable individual rates,

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<sup>1</sup>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).

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 . . . .

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).

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.<sup>2</sup> Therefore, there is nothing inherently wrong in KPC's power costs being passed along to its customers without a ratemaking proceeding in the Commission.<sup>3</sup>

### 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.

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<sup>2</sup>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.

<sup>3</sup>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.

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

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.

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BEN H. CANTRELL, JUDGE

CONCUR:

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SAMUEL L. LEWIS, JUDGE

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WILLIAM C. KOCH, JR., JUDGE



