



STATE OF TENNESSEE COMPTROLLER OF THE TREASURY

**Consumer Advocate Division
Office of the Attorney General and Reporter**

Performance Audit Report

August 2014

**Justin P. Wilson
Comptroller of the Treasury**



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August 26, 2014

The Honorable Ron Ramsey
Speaker of the Senate
The Honorable Beth Harwell
Speaker of the House of Representatives
The Honorable Mike Bell, Chair
Senate Committee on Government Operations
The Honorable Judd Matheny, Chair
House Committee on Government Operations
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
The Honorable Robert E. Cooper, Jr.
Attorney General and Reporter
425 Fifth Avenue North
Nashville, Tennessee 37243

Ladies and Gentlemen:

We have conducted a performance audit of selected programs and activities of the Consumer Advocate Division in the Office of the Attorney General and Reporter for the period July 1, 2011, through June 30, 2014. This audit was conducted pursuant to the requirements of Section 4-29-111, *Tennessee Code Annotated*, the Tennessee Governmental Entity Review Law.

Our audit resulted in no audit findings.

This report is intended to aid the Joint Government Operations Committee in its review to determine whether the Consumer Advocate Division should be continued, restructured, or terminated.

Sincerely,

Deborah V. Loveless, CPA
Director

DVL/jw
14/048

State of Tennessee

Audit Highlights

Comptroller of the Treasury

Division of State Audit

Performance Audit
Consumer Advocate Division
Office of the Attorney General and Reporter
August 2014

AUDIT SCOPE

We have audited the Consumer Advocate Division in the Office of the Attorney General and Reporter for the period July 1, 2011, through June 30, 2014. Our audit scope included a review of the division's internal control and compliance with laws, regulations, and provisions of contracts. Management of the Consumer Advocate Division is responsible for establishing and maintaining effective internal control and for complying with applicable laws, regulations, and provisions of contracts.

The Office of the Attorney General and Reporter, which includes the Consumer Advocate Division, does not receive any federal financial assistance listed under the *Rules of the Human Rights Commission*, Chapter 1500-01-03-.02(7); therefore, the office is not subject to the *Rules of the Human Rights Commission*, Chapter 1500-01-03, "Title VI Compliance Program."

According to the Tennessee Governmental Accountability Act of 2002 (revised 2013), the Office of the Attorney General and Reporter is not subject to performance-based budgeting. Therefore, the office is exempted from the strategic planning program performance measures and performance review requirements.

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

CONCLUSIONS

The audit report contains no findings.

**Performance Audit
Consumer Advocate Division
Office of the Attorney General and Reporter**

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**Performance Audit
Consumer Advocate Division
Office of the Attorney General and Reporter**

INTRODUCTION

PURPOSE AND AUTHORITY FOR THE AUDIT

This performance audit of the Consumer Advocate Division in the Office of the Attorney General and Reporter was conducted pursuant to the Tennessee Governmental Entity Review Law, *Tennessee Code Annotated*, Title 4, Chapter 29. Under Section 4-29-236, the Consumer Advocate Division is scheduled to terminate June 30, 2015. The Comptroller of the Treasury is authorized under Section 4-29-111 to conduct a limited program review audit of the division and to report to the Joint Government Operations Committee of the General Assembly. This audit is intended to aid the committee in determining whether the Consumer Advocate Division should be continued, restructured, or terminated.

Within the organization of the Office of the Attorney General and Reporter under the Consumer Advocate and Protection Division, duties of the Consumer Advocate are carried out by the Consumer Advocate Team. Going forward in this report, the Consumer Advocate Division as cited in Section 4-29-236 will be called the Consumer Advocate Team.

ORGANIZATION AND STATUTORY RESPONSIBILITIES

Established in 1994 by the General Assembly pursuant to Section 65-4-118, *Tennessee Code Annotated*, the Consumer Advocate Team represents the interests of Tennessee consumers of investor-owned electric, natural gas, telephone, water, and sewer companies. Generally, the team seeks to enforce laws applicable to public utilities, to remove barriers to competition in public utilities markets, and to seek a healthy balance between regulation, competition, and the public interest.

As of August 2014, the Consumer Advocate Team had six employees: one Deputy Attorney General,¹ three attorneys, one paralegal, and one legal secretary. The regulatory financial analyst position was vacant. The team's revenues and expenditures for fiscal years 2012, 2013, and 2014 are exhibited in the table on the following page.

¹ While the Deputy Attorney General supervises the Consumer Advocate Team, the position is not budgeted to the Consumer Advocate Team since the deputy also supervises the Tennessee Consumer Protection Act, Antitrust, Unauthorized Practice of Law, and State False Claims functions within the Office.

**Consumer Advocate Division
Revenues and Expenditures
Fiscal Years 2012 to 2014**

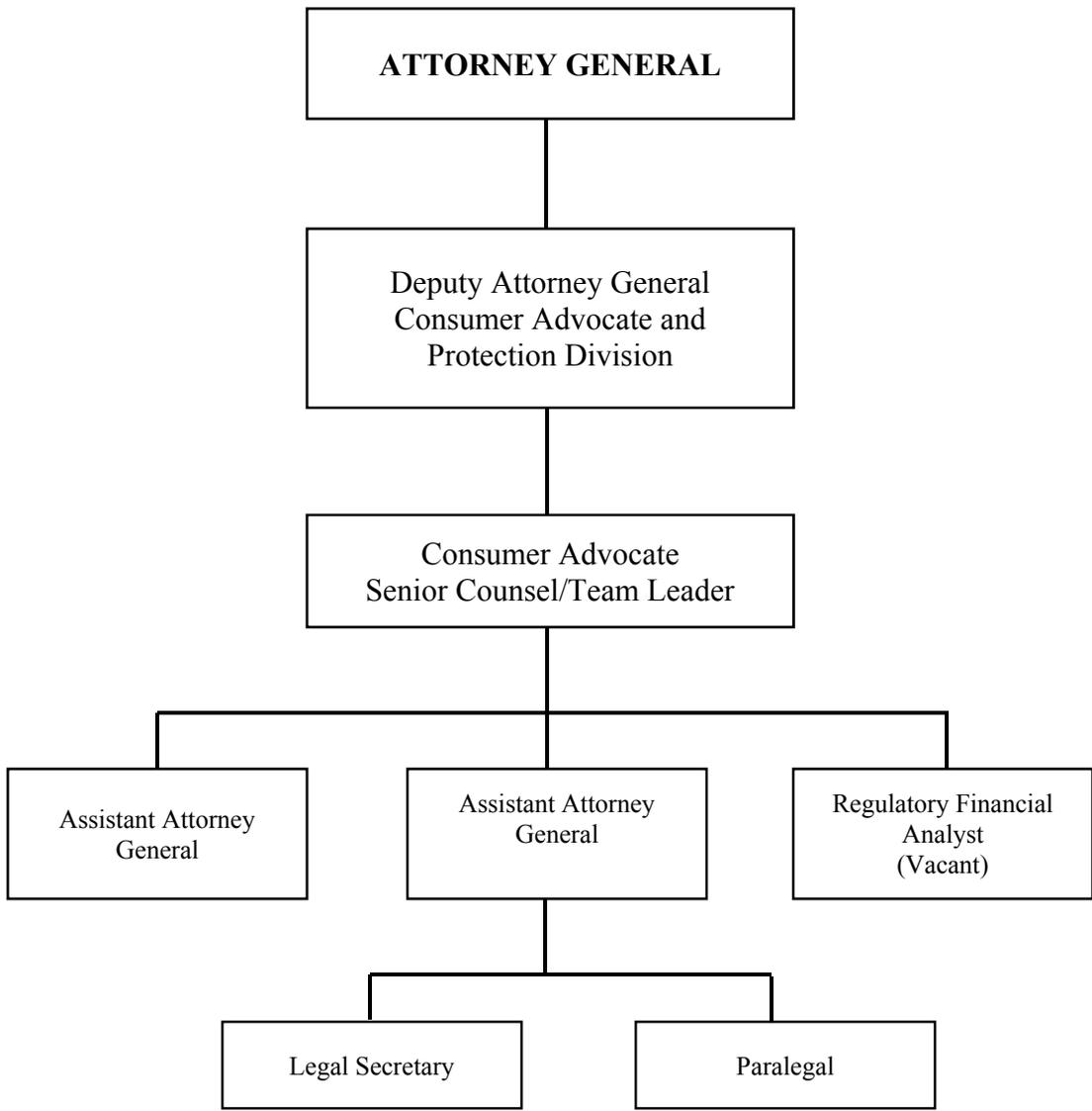
	2012	2013	2014*
Revenue:			
Appropriations	\$ 1,145,784	\$ 847,865	\$ 224,125
Expenditures:			
Salaries & Benefits	906,935	535,621	157,903
Operations	238,849	312,244	66,222
Total Expenditures	\$ 1,145,784	\$ 847,865	\$ 224,125

Source: Deputy Attorney General over Administration.

* As of December 31, 2013.

An organization chart of the Consumer Advocate Team is on the following page.

Consumer Advocate Team
Office of the Attorney General and Reporter
Organizational Chart
July 2014



AUDIT SCOPE

We have audited the Consumer Advocate Team in the Office of the Attorney General and Reporter for the period July 1, 2011, through June 30, 2014. Our audit scope included a review of the team's internal control and compliance with laws, regulations, and provisions of contracts. Management of the Consumer Advocate Team is responsible for establishing and maintaining effective internal control and for complying with applicable laws, regulations, and provisions of contracts.

The Office of the Attorney General and Reporter, which includes the Consumer Advocate Team, does not receive any federal financial assistance listed under the *Rules of the Human Rights Commission*, Chapter 1500-01-03-.02(7); therefore, the office is not subject to the *Rules of the Human Rights Commission*, Chapter 1500-01-03, "Title VI Compliance Program."

According to the Tennessee Governmental Accountability Act of 2002 (revised 2013), the Office of the Attorney General is not subject to performance-based budgeting. Therefore, the office is exempted from the strategic planning program performance measures and performance review requirements.

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS

BACKGROUND OF THE RELATIONSHIP BETWEEN THE CONSUMER ADVOCATE TEAM AND THE TENNESSEE REGULATORY AUTHORITY

The Consumer Advocate Team represents consumers in regulatory proceedings before the Tennessee Regulatory Authority (TRA) that involve setting rates for investor-owned utilities, reviewing petitions involving other matters (e.g., mergers and acquisitions, accounting changes, etc.) that investor-owned utilities bring before TRA, and monitoring complaints filed against various investor-owned utilities in the state. Established by Section 65-1-101, *Tennessee Code Annotated*, TRA is charged with setting rates for public utilities, which are defined by Section 65-4-101, *Tennessee Code Annotated*, while also considering consumer expectations. According to TRA's Criteria for Establishing Just and Reasonable Rates,

In setting rates for public utilities, the Authority is required to balance the interests of the utilities subject to its jurisdiction with the interests of Tennessee

consumers...The Authority must approve rates that provide regulated utilities the opportunity to earn a just and reasonable return on their investments while avoiding the exploitation of consumers by not setting exorbitant rates.

As of May 2014, TRA regulated 4 electric utilities, 6 gas utilities, 11 wastewater utilities, and 6 water utilities. Examples of these utilities are Kingsport Power Company, Piedmont Natural Gas, and Shiloh Falls Utilities, which offers both wastewater and water services. TRA does not regulate utilities that are owned by any agency of the United States, utilities that are part of any county, municipal corporation, or other subdivision of the state, such as Nashville Electric Service, and other specific organizations defined in Section 65-4-101(6).

TRA allows the utility companies under its authority to operate without competition due to the capital necessary to operate in their respective industry (i.e., gas, water, and/or electric utilities) and receive a reasonable return on investment. However, without competition, TRA must regulate (or oversee) the utilities to ensure fairness.

When necessary, public utility companies regulated by TRA are required to file a petition, which is a request for a rate increase and/or changes to other matters for TRA's consideration and approval. Once a petition is filed, TRA generates a docket, which is a case folder that contains the proceedings, dates, and other official documentation relating to the petition. The Consumer Advocate Team reviews the dockets and other matters, and if necessary to protect consumers, the team will petition to intervene in a case by participating in proceedings, offering expert testimony, and filing legal motions and briefs as necessary.

CONSUMER ADVOCATE TEAM CASE INTERVENTION

We examined the process the Consumer Advocate Team uses to select utility rates cases in which to intervene; the team's statutory requirements; and the team's use of contracts for expert witnesses when intervening in proceedings on consumers' behalf. In order for the Consumer Advocate Team to become involved in a case, the team must first assess the reasonableness of the utility company's petition for a rate change. It must identify the utility company's reason for the requested rate change in order to determine the best course of action. Underlying basis (bases) of the petition may be the utility company's service costs; the utility company's cost of raw materials; regulatory requirements imposed on the utility company; and the costs to recover from natural disasters.

If the team deems the utility company's petition reasonable, it will not intervene. According to management, the team may not intervene for a variety of reasons, including

- the best interests of the affected consumers;
- a particular statutory or other regulatory consideration; or
- the particular matter's not rising to a level of significance to warrant intervention.

For example, large, multi-state utility companies such as Appalachian Power Company, a unit of American Electric Power that conducts business in Kingsport, Tennessee, under Kingsport Power Company often have matters that are approved by the Federal Energy Regulatory Commission and/or other states' regulatory authorities prior to petitioning TRA. In such cases, the Consumer Advocate Team may not oppose such authorities, especially those that are backed by federal legislation and have already been approved in other states. Should the team be unable to conclude that any utility company's petition is reasonable, they will immediately request to intervene by filing a "petition to intervene" with TRA.

According to Section 65-5-103, *Tennessee Code Annotated*, petitions must be resolved within nine months from the filing date. Beginning in 2013, however, a new statute has allowed public utilities to petition for rate changes using an alternative regulatory method. According to management, in 2013 the General Assembly enacted Section 65-5-103(d), *Tennessee Code Annotated*, authorizing TRA to implement alternative regulatory methods allowing public utilities to adjust customer rates on an expedited basis outside of the traditional rate case process. Under the new statute, public utilities may request, and TRA may authorize, mechanisms to recover operational expenses, capital costs, or both, if these expenses or costs are found to be in the public interest. The statute also permits a public utility to opt out of the traditional rate case process by filing for an annual review of customer rates based on the methodologies adopted in the utility's most recent rate case. Under these alternative methods, the petitions must be resolved within four months from the date of filing.

According to Consumer Advocate Team management, the team's success is primarily measured by the amount of savings passed to consumers of public utilities in Tennessee. Success can also be defined by the number of rate cuts or quality of services the utilities provided to customers.

The objectives of our review were to determine

- the process the team used to select cases to intervene;
- whether rate case petitions were resolved within nine months, or four months for petitions involving alternative regulatory methods, as required by statute;
- whether the team accurately calculated the savings passed on to Tennessee consumers based on successful representation of cases; and
- if the team's staffing levels were sufficient to fulfill its responsibilities to pursue any case the team identified for intervention.

To gain an understanding of the duties of the Consumer Advocate, we interviewed key team personnel. We also interviewed key personnel within TRA in order to determine the relationship between TRA and the Consumer Advocate Team.

We obtained a population of 55 TRA cases, which represented petitions filed with TRA with an original filing date on or after July 1, 2011, through February 21, 2014. For all 55 cases,

we reviewed the case notes and other supporting documentation to determine the reason the Consumer Advocate Team did or did not intervene. We also conducted research to compare the team's case selection process with other states.² Of the 55 TRA cases, only 8 cases represented matters involving traditional rate cases; for six of these cases, TRA issued a final order.

We reviewed Section 65-5-103, *Tennessee Code Annotated*, to determine the statutory deadlines. We tested all six rate cases by reviewing the cases' final orders issued by TRA to determine if the cases were resolved within the statutorily mandated deadlines.

In order to determine the accuracy of savings passed on to Tennessee consumers, we obtained the Office of the Attorney General and Reporter's 2011 and 2012 annual reports; a list of Tennessee's public utilities regulated by TRA from TRA's website; a list of rate case docket numbers filed in calendar years 2011 and 2012 from TRA's Chief of Utilities Division; and the actual rate case dockets from TRA's website. We then compiled this information, calculated the savings, and compared our calculations to the amounts reported in the annual reports.

We viewed the February 13, 2014, budget hearing for the Office of the Attorney General and Reporter as it relates to the Consumer Advocate Team. To determine if staffing levels were sufficient to provide case intervention when necessary, we also obtained three lists:

- funded positions filled and vacant within the team, as of April 25, 2014;
- team employees who were hired or terminated from July 1, 2011, through January 23, 2014; and
- the team's attorneys' case assignments for the period July 1, 2011, through February 21, 2014.

We then analyzed all three lists to determine whether staff availability was sufficient to fulfill the team's responsibilities for case intervention.

Based on the procedures performed, we determined that

- the team's process for selecting cases was appropriate;
- petitions were resolved within the statutorily mandated deadlines;
- the Consumer Advocate Team accurately calculated savings of over \$6 million and \$9 million in fiscal years 2011 and 2012, respectively, to Tennessee consumers of public utilities; and
- staffing levels were sufficient to fulfill the team's responsibilities.

² National Regulatory Research Institute, "The Role of Utility Consumer Advocates in a Restructured Regulatory Environment," September 2004; State of Utah Office of the Utah Legislative Auditor General, "A Performance Audit of the Committee of Consumer Services," January 2009; and the State of New Hampshire Office of Legislative Budget Assistant, "State of New Hampshire Public Utilities Commission and its Administratively Attached Agencies: Performance Audit April 2012."

OTHER STATUTORY REQUIREMENTS

In addition to its duty and authority to represent the interests of Tennessee consumers of public utility services, the Consumer Advocate Team must also be aware of changes to the public utilities industries. According to team management, the telecommunications industry has changed significantly over the years, and telecommunications industry rates and terms of service are today essentially unregulated. The deregulation has reduced the number of petitions (cases) and the need for case intervention. The objective of our review of this section was to determine the process the Consumer Advocate used to stay up-to-date on changes to the utility regulatory environment.

To gain an understanding of the team's process to review changes to the utility regulatory environment, we interviewed key personnel within the team and TRA and reviewed supporting documentation. We also reviewed Section 65-5-103, *Tennessee Code Annotated*.

Based on the procedures performed, we determined that the team used different mechanisms to respond to the changing regulatory environment. It held internal meetings, requested additional funds for outside experts, moved records to an electronic format, and participated in seminars and conferences.

CONTRACTS FOR EXPERT WITNESSES

During the audit period, the Consumer Advocate Team contracted with four individuals to act as expert witnesses on regulatory matters. According to management, the team contracts with utility regulations experts who are willing to testify and defend their opinions before the TRA. These regulatory utility analysts and regulatory economists offer general consulting services, document reviews, prepare written testimony for proceedings before the TRA, and appear and testify for a deposition or before the TRA. The objectives of our review of contracts for expert witnesses were to determine

- whether contracting with experts was cost-beneficial or not detrimental to the state;
- if payments to expert witnesses complied with the terms of their contract; and
- if the team appropriately reviewed and approved invoices prior to payment for services.

We interviewed key Consumer Advocate Team employees to gain an understanding of their use of expert witnesses and their process for selecting expert witnesses to support the responsibilities of the team. We then obtained and reviewed the contracts and amendments for all four expert witnesses the team retained from July 2010 through March 2014.

To determine the cost effectiveness of using expert witnesses, we obtained the salary of a former team employee who was under contract as an expert witness during our audit, and compared his salary and benefits paid as a state employee to the total payment he received as a

contractor during fiscal year 2013. We also conducted Internet research on salaries for regulatory economists to determine an approximate salary range, then compared it to the total paid to the regulatory economist under contract with the team.

We asked the Office of the Attorney General and Reporter’s Deputy Attorney General over Administration and the Fiscal Director how the Consumer Advocate Team ensures expert witnesses complied with the terms of their contracts. We obtained a population of 32 expenditure transactions from Edison, the state’s accounting system, representing all payments to the contractors from July 1, 2012, through June 30, 2013, which totaled \$128,629. We tested all 32 transactions to determine if the contractors were paid in accordance with terms of their contracts and whether the transactions were properly reviewed and approved prior to payment.

Based on the procedures performed, we determined that

- based on our analysis, contracting with expert witnesses was not cost-detrimental to the state;
- payments to expert witnesses during our audit period complied with the terms of their contracts; and
- the team appropriately reviewed and approved invoices relating to contracts prior to issuing payments for services.

APPENDIX

TEAM DEMOGRAPHIC INFORMATION

**Consumer Advocate Division
by Gender and Ethnicity
July 2014**

	Gender		Ethnicity					
	<i>Male</i>	<i>Female</i>	<i>White</i>	<i>Black</i>	<i>Hispanic</i>	<i>Asian</i>	<i>American Indian</i>	<i>Other</i>
Deputy Attorney General	0	1	1	0	0	0	0	0
Team Leader/Senior Counsel	1	0	1	0	0	0	0	0
Assistant Attorney General	1	0	1	0	0	0	0	0
Paralegal	1	0	1	0	0	0	0	0
Legal Secretary	0	1	1	0	0	0	0	0
Total	3	2	5	0	0	0	0	0