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August 13, 2004

VIA HAND DELIVERY

Ms. Deborah Taylor Tate, Chairman
TENNESSEE REGULATORY AUTHORITY
460 James Robertson Parkway
Nashville, Tennessee 37243

Re: ***Petition of Tennessee Wastewater Systems, Inc. to Amend its Certificate of Convenience and Necessity*, Docket No. 03-00329**

Dear Chairman Tate:

Enclosed for filing in the above-referenced docket are the original and thirteen copies of the Post-Hearing Brief.

Should you have any questions with respect to this filing, please do not hesitate to contact me at the number shown above. Thank you in advance for your assistance with this matter.

Sincerely,

Gregory T. Young

GTY/kc
Enclosure

cc: Jim Gass, Esq. (w/enclosure)

2499029 1

BEFORE THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE

IN RE:	)	
	)	
PETITION OF ON-SITE SYSTEMS, INC. TO AMEND ITS CERTIFICATE OF CONVENIENCE AND NECESSITY	)	**Docket No. 03-00329**
	)	
and	)	
	)	
PETITION OF TENNESSEE WASTEWATER SYSTEMS, INC. TO AMEND ITS CERTIFICATE OF CONVENIENCE AND NECESSITY	)	**Docket No. 04-00045**

THE CITY OF PIGEON FORGE'S POST HEARING BRIEF

INTRODUCTION & ISSUES

On Tuesday, July 13, 2004, a hearing in this matter was held before Randal L. Gilliam, the Hearing Officer for the Tennessee Regulatory Authority (the "Authority") for this matter. At this hearing, Hearing Officer Gilliam verbally granted the Petitioner's application for a Certificate of Convenience and Necessity (hereinafter, "certificate" or "CCN") with respect to eight (8) specific developments within Sevier County to be set forth in a late-filed exhibit by Petitioner. (Transcript, pp. 70-71.) The Petitioner filed its Late-Filed Exhibit 1 on July 16, 2004, which sets forth seven (7) specific developments. (Late-Filed Exhibit 1, p. 2.)

At the July 13th hearing, Hearing Officer Gilliam withheld judgment as to whether a certificate should be granted to Petitioner for all of Sevier County, including the City of Pigeon Forge's (the "City") urban growth area. (Trans. at 71.) In order to aid his decision on this matter, Hearing Officer Gilliam requested that the parties submit post-hearing briefs on the following issues:

1. With respect to T.C.A. § 6-51-301, what does "utility water service" mean, i.e., does "utility water service" mean only potable water service or does it include sewer service? (Trans. at 66-67.)
2. Why is it in the present or future public convenience and necessity that Petitioner be granted a CCN for the entirety of Sevier County, as opposed to project-specific CCN's? (Trans. at 65-66.)

BRIEF SUMMARY

As to the first issue, the Tennessee Court of Appeals has assumed that the term "utility water service" includes sewer service within the scope of § 301. The Authority should recognize this decision and, considering the exclusive effect that granting the proposed countywide certificate could have on the City's extension of sewer services into the urban growth area, the Authority should deny Petitioner's application for a countywide certificate.

As to the second issue, present or future public convenience and necessity do not require or support Petitioner's proposed countywide certificate. Petitioner's convenience and necessity justifications involve convenience to private developers and to Petitioner itself. Petitioner's justifications do not correlate to public convenience and necessity. As such, Petitioner has failed to carry its burden as to the second issue. Moreover, Petitioner's decentralized and project-specific sewer systems are much better suited for project-specific certificates. Finally, potential substantial negative impacts to public convenience and necessity exist, including: (a) exclusion of the City from providing sewer service; (b) inconsistency with the State's regional plan for development in the City's urban growth area; and (c) anticompetitive effects with respect to sewer service. Because present and future public convenience and necessity do not and will not require the proposed countywide certificate, Petitioner's application should be denied.

ARGUMENTS & AUTHORITIES

I. The only court to address the utility water service issue has assumed that the term includes sewer service. The Authority should recognize this decision and deny Petitioner's application for a countywide CCN because of the potential exclusive effect of T.C.A. § 6-51-301.

Under Tenn. Code Ann. § 6-51-301(a)(1), "no municipality may render utility water service to be consumed in any area outside its municipal boundaries when all of such area is included within the scope of a certificate or certificates of convenience and necessity . . . in favor of any person, firm or corporation authorized to render such utility water service." "Utility water service" is not defined in the statute. The Tennessee Court of Appeals, however, has assumed that the term "utility water service" includes sewer service within the scope of the § 301. Lynnwood Utility Corp. v. City of Franklin, No. 89-360-II, 1990 WL 38358, at *3 (Tenn. Ct App. Apr. 6, 1990) (copy attached).

In Lynnwood, the plaintiff-public utility held a certificate to provide sewer services to part of an area annexed by the City of Franklin. Upon annexation, the plaintiff sued the City of Franklin for compensation under § 301(a). Id. Plaintiff had installed and was operating a sewer system for a large, new subdivision, but had no pipes in the ground, had not constructed any plant, had no equipment of any kind, and had not made any physical addition of any kind in the remainder of the newly annexed area. Id. The plaintiff claimed that it deserved just compensation from the city solely because the plaintiff held a certificate and was now deprived of providing sewer service to part of the annexed area. Id.

One of the issues presented to the Tennessee Court of Appeals was: "Does T.C.A. § 6-51-301(a) apply only to a purified water utility company and not to a sewer water utility company." Id. at *2. The Court of Appeals stated: "For purposes of this opinion we assume, without holding, that the term utility water service in the statute includes sewer service and that the sewer service provided

by Lynnwood comes within the statute." Id. at *3. The Court of Appeals then went on to hold that the certificate itself (as opposed to physical improvements) did not qualify as "facilities" under T.C.A. § 6-51-301(a)(2), and that plaintiff's compensation therefore did not exceed zero. Id. at *4.

There being no controlling authority to contradict the Lynnwood assumption, the Authority should recognize Lynnwood and assume for purposes of the countywide certificate at issue that the term "utility water service" includes sewer service within the scope of the § 301(a). The Authority does not have jurisdiction to limit Lynnwood or to make a final, binding determination regarding the meaning of utility water service in § 301 – only a court can take such action. When considering Petitioner's countywide certificate, the Authority should, therefore, take into account the fact that the only court to address the issue assumed that utility water service included sewer service similar to the decentralized type that Petitioner offers.

Failing to recognize Lynnwood not only ignores the only authority to address the issue, but also sets the stage for the a scenario as suggested by Hearing Officer Gilliam at the July 13th hearing (See, Trans. at 67). For example, a county school just beyond the City's corporate limits in the urban growth area has failing septic tanks and needs immediate City sewer service because the City's sewer system is best situated to service that school. (See, Pigeon Forge Exhibit 1, pp. 15-16 (evidencing county school's need for City sewer service).) The City, however, is forced to deny service to the school because it cannot afford to annex the entire area just so the school can have sewer service. The bottom line is that the Authority should recognize Lynnwood and consider the exclusive effects that granting the proposed countywide CCN could have on the City's extension of sewer service into areas outside of corporate boundaries.

It is well settled that a municipality has the power to extend sewer service to areas outside its corporate boundaries. Patterson v. City of Chattanooga, 241 S.W.2d 291, 294 (Tenn. 1951) ("This

Court has on numerous occasions approved the rule above announced, that a city may own and operate such [sewer systems] beyond its corporate limits."). The City has extended its sewer services outside of its limits into the urban growth area in the past, and currently provides such service within the urban growth area. (Direct Testimony of John Raymond Jagger on Behalf of the City of Pigeon Forge, p. 3.) In addition to emergency responses such as the school scenario above, the City may have strategic or economic efficiency reasons for such service extensions. However, based on the Lynnwood decision and Westland Drive Service Co. v. Citizens & Southern Realty Investors, 558 S.W.2d 439 (Tenn. Ct. App. 1977), if the Authority grants the proposed CCN, the City could be excluded under T.C.A. § 6-51-301(a)(1) from providing sewer service to these areas.

In Westland, the Knoxville Utilities Board ("KUB") began to provide "water services" in 1972 to an apartment complex, Timbers West, constructed immediately adjacent to and outside of the Knoxville corporate limits. Id. at 440. Westland had earlier obtained a certificate of convenience and necessity from the Tennessee Public Service Commission granting Westland an exclusive franchise to provide services throughout its certificated area, which included the site of the apartment complex. Id. After KUB began providing water services to Timbers West, Westland filed a complaint before the Commission in 1973. Id. The Commission simply reaffirmed that Westland had an exclusive franchise. Id. However, because the Commission had no jurisdiction over KUB and Timbers West, the Commission's order instructed Westland to "immediately proceed in a court of equity to insure that its franchise area is not infringed upon by KUB. . ." Id.

In 1975, Westland brought a lawsuit seeking to enjoin KUB from furnishing water to the apartment complex pursuant to T C.A. § 6-51-301(a)(1) (then, § 6-319). Id. The Chancellor dismissed the lawsuit in favor of KUB, apparently because "it would be inequitable and unjust to require Timbers West to disconnect from KUB's service and hook on to Westland's facilities." Id. at

441. The Court of Appeals affirmed the dismissal, but solely on the grounds that the language in the first sentence of § 6-51-301 did not come into effect until April 5, 1974 – nearly two years after KUB began providing water service to Timbers West. Id. Therefore, prior to the enactment of the provision, "it was not a violation of the Tennessee statutes for KUB to serve Timbers West." Because the 1974 amendment could not apply retroactively, it "would have no effect on KUB and Timbers West's valid 1972 agreement." Id.

The clear implication of Westland and Lynnwood is that, from 1974 forward, the first sentence of T.C.A. § 6-51-301(a) excludes a municipality from providing sewer service to an area outside its municipal boundaries when such area is already within the scope of a certificate of convenience or necessity.

Section 301(a) and the Lynnwood and Westland decisions pose significant concerns to the City if Petitioner's application for a countywide CCN is granted. If the Authority grants the CCN, what would happen to the current sewer service being provided in the urban growth area? Should the City cease, or could the City be required to cease such operations? In addition, granting the proposed CCN could impair the City's ability to efficiently and cost-effectively extend sewer service into the urban growth area as its utility infrastructure is expanded.

The exclusive consequence of a countywide CCN would be by operation of law, and not because the Authority intended such a consequence. Unfortunately, because the exclusivity is created under an annexation statute in the Tennessee Code, if a countywide CCN is granted, the Authority would be powerless to avoid the adverse consequences to the City. The Authority's only recourse is to deny the Petitioner's application for a countywide CCN and allow Petitioner to apply for certificates on a project-by-project basis.

II. Present and future public convenience and necessity do not require or support Petitioner's proposed countywide certificate and the Authority should deny it.

Section 65-4-201(a) of the Tennessee Code states:

> No public utility shall establish or begin the construction of, or operate any line, plant, or system, or route in or into a municipality or other territory already receiving a like service from another public utility, or establish service therein, without first having obtained from the authority, after written application and hearing, a certificate that the present or future public convenience and necessity require or will require such construction, establishment, and operation . . .

Under § 201(a), it is the Petitioner's burden to demonstrate how present or future public convenience and necessity require or will require the proposed establishment, construction, and/or operation of its sewer services. Petitioner does not and cannot satisfy this burden with respect to its application for a countywide CCN.

The Authority possesses broad discretion in determining whether a regulated utility's proposed certificate is required by present or future public convenience and necessity. See, BellSouth Advertising & Publishing Corp v. Tennessee Regulatory Authority, 79 S.W.3d 506, 512-13 (Tenn. 2002) (noting the General Assembly's "clear intent to vest in the [TRA] practically plenary authority over the utilities within its jurisdiction.") The Tennessee Supreme Court construes the statutes governing the Authority liberally to further the legislature's intent to grant broad authority to the Authority. Id. at 513. "Statutory provisions relating to the authority of the TRA shall be given a 'liberal construction' " and " 'any doubts as to the existence or extent of a power conferred on the [TRA] . . . shall be resolved in favor of the existence of the power, to the end that the [TRA] may effectively govern and control the public utilities placed under its jurisdiction.' " Id. at 512 (quoting T.C.A. § 65-4-106).

The fact that Petitioner seeks a broad, geographically-based certificate necessarily broadens the Authority's evaluation of factors that affect present and future public convenience and necessity. As such, the Authority must not only consider Petitioner's proffered evidence of convenience and necessity (which does not satisfy Petitioner's burden), but also the decentralized nature of Petitioner's operations and the multiple, negative impacts to public convenience and necessity that would result from granting the proposed countywide certificate. See, T.C.A. § 65-2-109 (providing that Authority may give probative effect to any evidence that would be accepted by reasonably prudent persons).

A. Petitioner's decentralized and project-specific sewer systems are much better suited for project-specific certificates.

A geographically-based territory does not make sense for the decentralized sewer services that Petitioner offers. It is our understanding that a decentralized sewer system is self-contained and includes a treatment facility for a specific project or development, such as a planned unit development (condos, apartments, housing developments, etc.). On the other hand, a centralized sewer system like the City operates uses a network of lines, mains and pumping stations all leading to a processing facility for treatment. A decentralized sewer system enables project development on a property that would otherwise be inappropriate for more conventional septic systems, and, because of the property's location, does not have a centralized sewer service system available to it.

Unlike centralized sewer systems, these decentralized systems can be installed and operated anywhere. They are not dependent upon the existence and availability of an area-wide infrastructure like sewer mains and treatment facilities. Therefore, whereas geographic areas may make sense for centralized utilities, geographic areas have little to do with the rendering of services for decentralized systems.

In fact, Petitioner's own evidence of convenience and necessity only addressed eight specific projects, not the geographic area of the entire county. Because of the project-specific nature of Petitioner's services, it is possible to show need on demand, but it is more difficult to show need where there is no current demand. Such is the case here. Petitioner was granted a certificate covering specific developments, but Petitioner has failed to carry its burden to show that public convenience and necessity require a countywide certificate. For this reason and others discussed herein, it simply makes more sense for the Authority to deny Petitioner's application for a countywide CCN and allow Petitioner to obtain project-based certificates.

B. Public convenience and necessity do not require or support Petitioner's proposed certificate because such certificate could exclude the City from providing sewer service to the urban growth area.

As more fully discussed in Section I of this Brief, under the Westland and Lynnwood decisions, from 1974 forward, the language in the first sentence of T.C.A. § 6-51-301(a) could exclude the City from providing sewer service to its urban growth area if such area is within the scope of Petitioner's certificate. Because of the significant negative impacts to the public associated with this exclusion, Petitioner's proposed countywide certificate is not required or supported by public convenience and necessity.

C. Public convenience and necessity do not require or support Petitioner's proposed certificate because such certificate is inconsistent with the state's regional plan for development in the Pigeon Forge urban growth area.

The proposed certificate is inconsistent with the state's regional plan for Pigeon Forge's urban growth area. The State of Tennessee, through the Department of Economic and Community Development, has organized a system whereby planning regions are created across the state to encourage efficient and orderly development. See, T.C.A. 13-3-101 *et seq.* As Mr. Jagger testified, through cooperation between the Department of Economic and Community Development, Sevier

County, and the City of Pigeon Forge, the state designated Pigeon Forge's Planning Commission as the state regional planning commission for the urban growth area pursuant to T.C.A. § 13-3-102. (Jagger Testimony at 3; Pigeon Forge Exhibit 3.)

Urban growth areas by definition are areas identified as future parts of the municipality as development occurs and services are made available. Municipalities like Pigeon Forge have a vested interest in the orderly and efficient development of the urban growth area, since its utility infrastructure will become part of the City's infrastructure. This explains one reason why the state designated the City's planning commission as the state's planning commission for development in the urban growth area.

Petitioner's proposed "blanket" countywide certificate for Sevier County, including the City's entire urban growth area, is inconsistent with the City's urban growth plan. Such a certificate promotes chaotic and inefficient development in the urban growth area, thereby undermining the urban growth plan and straining the ability of the City to meet all the utility needs of the residents in the urban growth area. Obviously, a plan for orderly and efficient growth looks for development in a manner in which roads and other essential utilities can be available in a reasonable and cost effective manner. Premature development made possible by the availability of certain utilities, but not all utilities puts a strain on a development plan.

For example, under Petitioner's proposed geographically-based certificate, Petitioner could agree to serve a project in the urban growth area without further review by the Authority. This project may be in an area where the current urban growth plan does not provide for general utilities support (roads, water, sewer, etc) for several more months. The project's development at the wrong time then causes a burst of unexpected development and results in a stress on the other utilities contrary to the City's plans.

The Authority should consider such consequences and seek to compliment and dovetail its own public convenience and necessity determination with other public need determinations made by the State. By entertaining certificates on a project-by-project basis, the approval process would allow the Authority to hear evidence on the subject project's consistency with the other needs determinations for the county and the urban growth area. This is particularly true in areas such as urban growth areas, where concerted efforts are made by the State to provide for orderly and efficient development. For this reason and others asserted herein, Petitioner's application for a countywide certificate should be denied.

D. Petitioner's evidence of convenience and necessity does not provide the Authority with sufficient justification to issue a countywide CCN.

During the examination of Charles Pickney, Jr. at the July 13th hearing, Officer Gilliam succinctly summarized the Petitioner's proffered evidence of convenience and necessity as follows:

> MR. GILLIAM: Okay. In your prefiled testimony, you identified two basic reasons that Tennessee Wastewater is requesting that the CCN encompass all of Sevier County with the noted exceptions, that being essentially the convenience to the general contractors that the company works with in terms of the amount of time that it takes from the time you begin your discussions to the time you have an order in writing that you can use to meet the other obligations you have in dealing with the legal government and so forth.
>
> Then the other basi[c] reasons I think we've hit on a little bit today is the general administrative cost of coming to the TRA and filing individual petitions versus filing one petition to cover a larger area. I don't want to leave any thing out. Are there any other reasons that come to mind for asking for the CCN to cover the area that you requested?
>
> THE WITNESS: Well, I think just common sense would say if we've got 30 systems there in that general area, our maintenance people can very effectively go from one subdivision to the next and cover it much better than if you've got five different companies and the things are scattered all over the place. There are some efficiencies to be had down the road in maintenance and operations.

> We're able to serve a large scale area just because of the effectiveness of our maintenance people. I don't know how to maybe say that right, but its just that it's going to be more effective if we're serving 30 there than if we're serving 10 someplace else and 15. Having a concentration of customers does make for more efficient maintenance.

(Trans. at 26-27 (emphasis added).)

Based on Mr. Pickney's testimony, Petitioner asserts that its application for a countywide CCN is required by the present and future public convenience and necessity for three reasons: (1) the convenience to developers; (2) the convenience to Petitioner; and, (3) maintenance efficiencies. These reasons are distinguishable on their face from the public convenience and necessity interests that are required to obtain a CCN. Petitioner tries to relate these reasons to public interests by arguing these costs are passed down to its customers. However, Mr. Pickney's own testimony negates any argument that these reasons are supported or required by public convenience and necessity.

Petitioner asserts that project-specific certificates are inconvenient for the developers that contact Petitioner to provide sewer service for new developments. (Pre-Filed Direct Testimony of Charles Pickney, Jr., p. 3.; Trans. at 26-27, 41.) A real-estate developer's specific interests do not necessarily equate to public convenience and necessity for the entire county or the urban growth area, however. A developer's primary interest is to make money, even if a development is neither convenient nor necessary to the public. Even if you assume that the developer's need is a public need, such need is for the specific project in question, and cannot be relied upon in a determination of the need for the county as a whole, or the City's urban growth area.

Petitioner likewise asserts that project-specific certificates are inconvenient to Petitioner because Petitioner must spend time and money obtaining a certificate from the Authority. (Pickney

Pre-filed Testimony, at 3; Trans. at 26-27, 41.) Once again, the profit interests of Petitioner must be distinguished from public convenience and necessity.

Petitioner's "administrative convenience" argument as to the costs that Petitioner must bear in obtaining a CCN appears to be without merit. Based on the testimony of Mr. Pickney, it appears that Petitioner's monetary costs of obtaining a CCN are fully compensated, if not overly compensated, via a 40-cent per month miscellaneous expenses category that is billed to its customers – forever. (Trans. at 56-57.) In the City's urban growth area alone, Petitioner serves approximately 200 customers, which based on the 40-cent charge translates into about $80 per month, which translates into almost $1,000 per year – for an infinite duration – to defray Petitioner's administrative expenses. (Id.) It is our understanding that the cost to apply for a certificate from the Authority is $25. Petitioner surely cannot complain that it is inconvenienced, and the 40-cent rate probably merits review by the Authority to protect the public's interest.

Petitioner's "administrative convenience" arguments further fall short of the required public convenience and necessity showing that Petitioner must make in this case, because of the potential for adverse, substantive impacts to the public that would result from the proposed countywide CCN. Such impacts to the public (as discussed in more detail above and below) include: (a) potential exclusion of the City from providing sewer service; (b) inconsistency with the State's regional plan for development in the City's urban growth area; and, (c) anticompetitive effects with respect to sewer service.

Petitioner's "administrative convenience" arguments are further called into question by the fact that the Authority has demonstrated the ability and capacity to handle project-based certificates from the Petitioner. Mr. Pickney admits that he cannot recall Petitioner ever being denied an application for a CCN before the Authority, and that Petitioner has not suffered from having to go

through the application process (Trans at 44, 57.) Furthermore, the Authority demonstrated its ability to award a multi-development, project-based certificate at the July 13th hearing. There is nothing to stop Petitioner from obtaining such multi-development certificates in the future for developments in areas where rapid growth is occurring.

Petitioner's "maintenance efficiency" justification is invalid and does not make sense. (See, Trans. at 27.) Mr. Pickney basically testifies that if Petitioner has a monopoly over the decentralized sewer service in Sevier County, then it can provide more efficient maintenance of the independent, decentralized systems. (Id.) First, even if we accept the proposition that maintenance efficiencies will occur, these efficiencies do not translate into a basis for public convenience and necessity. Any monopoly by its very nature provides certain efficiencies. Eating out would be more efficient if McDonald's was the only restaurant. However, not all efficiencies are a benefit to the public. Something that makes it easier to perform maintenance for Petitioner may not improve maintenance for the end-users or the cost of those maintenance services cheaper.

Second, Petitioner itself would not be handling maintenance activities in Sevier County. Since Petitioner has just one employee, Mr. Pickney, Petitioner sub-contracts all of such maintenance work to independent contractors. (Trans. at 34-35.) According to Mr. Pickney, the quality of the service that Petitioner provides depends primarily on the quality of the subcontractors it finds and hires. (Trans. at 35.)

Because of Petitioner's use of subcontractors, whether Petitioner owns and operates all of the decentralized sewer systems in a geographic area versus other companies competing in the area should make no difference with respect to Petitioner's maintenance efficiencies. If there is a lot of maintenance to be conducted in different areas, Petitioner simply hires the appropriate independent contractors to handle the workload:

> MR. PICKNEY: Well, basically, we're a company that operates with subcontractors. The way we're set up here in this state and in other states where we're serving in wide areas is that we find technical, competent people in the regions that we want to serve. We basically put them under contract to provide the service. They in turn look to the most efficient way to get their maintenance, and so forth, done. If that company doesn't have maintenance capabilities, they would subcontract for that.

(Trans. at 33-34.) These independent contractors are presumably located near the sewage systems of Petitioner that they service. (Id.) Maintenance of these systems therefore generally does not involve sending somebody from Petitioner to fix something – the Petitioner hires a local independent contractor takes care of the maintenance.

In summary, Petitioner's proffered evidence of convenience and necessity does not correlate, and is easily distinguishable from the required public convenience and necessity that must be demonstrated to obtain a geographically-based CCN. Petitioner has failed to provide any basis or overriding reason for the Authority to consider granting the proposed geographic-based certificate, as opposed to a project-based certificates.

E. Public convenience and necessity do not require or support Petitioner's proposed certificate because such certificate would stifle competition to the detriment of public.

In the July 13th hearing, both Petitioner and the Intervenors discussed the Authority's role in preserving competition. The City submits that the Authority has general power to consider the effect of a proposed certificate on competition. See, BellSouth BSE, Inc. v. Tennessee Regulatory Authority, No. M2000-00868-COA-R12-CV, 2003 WL 354466, *10-*11 (Tenn. Ct. App., Feb. 18, 2003) (copy attached) (holding Authority acted within relevant statutory authority when considering the effect on competition of an application for statewide certification as a competing local exchange company as part of the Authority's consideration of public convenience and necessity under § 65-4-

201(a)).

While agreeing with Petitioner that the Authority's priority should be getting service to customers at the most reasonable cost (Trans. at 16.), the City submits that the best way to do so here is to preserve competition by denying Petitioner's application for a countywide certificate. The public is better served by competition with respect to Petitioner's sewer services because competition generally results in lower prices for the consumer public.

Because Petitioner's services involve decentralized, site-specific applications, Petitioner's services are distinguishable from traditional "regulated monopoly" utility services that involve massive networks of lines or pipes throughout a geographic area. The "regulated monopoly" concerns about duplication of services and strength and ability to provide services do not exist here. Furthermore, the Authority ensures that each decentralized sewer service provider is strong and able to serve when a certificate is sought.

Petitioner's arguments with respect to competition are disingenuous double-speak. Petitioner asserts that without a geographically based certificate, it is at a competitive disadvantage and, therefore, needs the proposed certificate to level the playing field. This argument is based on the fact that in order to provide sewer services, Petitioner must go through the certificate process and be "authorized" before it can provide such services for a particular project. The competitive disadvantage in such argument comes from the fact that neither the City nor a utility district has to obtain a certificate from the Authority before offering similar or alternate sewer services.

This argument is flawed in several respects. Granting a geographically-based certificate would not level the playing field, but rather would grant Petitioner a competitive advantage over other public utilities, as well as municipalities and utility districts. With respect to other public utilities regulated by the Authority, a project-based certificate approach is a level playing field, as

every public utility must go through the same process in order to provide sewer services.

Non-regulated entities providing similar or alternative services are regulated or controlled under other restrictions and limitations established by the legislature under state law. By asking the Authority to try to level the playing field with such non-regulated entities, Petitioner places the Authority in an awkward position of creating unintended consequences because of the complex interplay of various state statutes. For example, one consequence of granting a geographically-based certificate could be to exclude the City from providing services in the certificated area. That would not be a level playing field.

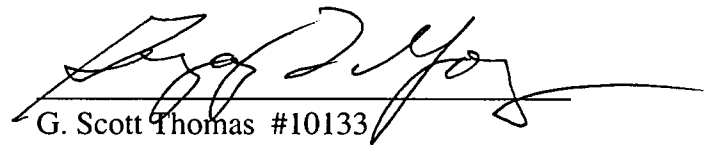
A geographically based area for the certificate in this circumstance would discourage competition among public utilities. A geographically based certificate would make it difficult, if not impossible, for another public utility to provide sewer services in that certificated area. This creates a monopoly for Petitioner, and as we have already demonstrated, may create a similar exclusivity that extends to non-regulated entities like the City and perhaps utility districts. There are multiple sources of sewer service available within the urban growth area, and it is counter-productive to reduce the competition for such services. For this reason and others asserted herein, Petitioner's application for a countywide certificate should be denied.

CONCLUSION

For the reasons stated herein, the City respectfully requests that the Authority deny Petitioner's application for a countywide certificate.

Dated this 13th day of August, 2004.

Respectfully submitted,



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CERTIFICATE OF SERVICE

I hereby certify that a true and exact copy of the foregoing has been served on the following, via U.S. Mail, postage prepaid, this the 13th day of August, 2004.

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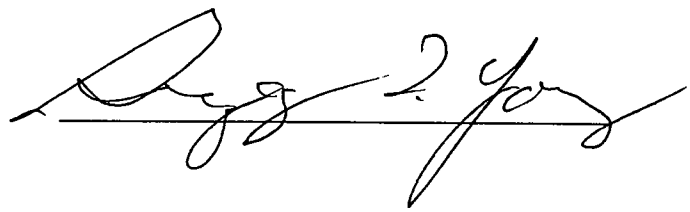

Westlaw.

1990 WL 38358
118 P.U.R.4th 288
(Cite as: 1990 WL 38358 (Tenn.Ct.App.))

SEE COURT OF APPEALS RULES 11 AND 12

Court of Appeals of Tennessee, Middle Section at Nashville.

LYNNWOOD UTILITY COMPANY,
Plaintiff-Appellant.
v
THE CITY OF FRANKLIN, TENNESSEE,
Defendant-Appellee.

April 6, 1990

Appeal No 89-360-II, Williamson Equity, Appealed from the Chancery Court for Williamson County, Henry Denmark Bell, Chancellor.

Harris A. Gilbert, J. Graham Matherne, Wyatt, Tarrant, Combs, Gilbert & Milom, Nashville, for plaintiff-appellant

William L. Baggett, Jr., Farris, Warfield & Kanaday, Nashville, Charles W. Burson, Attorney General and Reporter, John Knox Walkup, Solicitor General, Michael W. Catalano, Deputy Attorney General, Nashville, for defendant-appellee.

OPINION

LEWIS, Judge.

***1** Plaintiff Lynnwood Utility Company (Lynnwood) filed its complaint against defendant, The City of Franklin, Tennessee (Franklin), in which Lynnwood sought compensation from Franklin for Franklin's alleged taking of Lynnwood's right to serve an area in North Williamson County, Tennessee, with utility **sewer** service. Franklin had annexed the area in question subsequent to the Tennessee Public Service Commission (PSC) granting Lynnwood a "Certificate of Convenience and Necessity" to provide utility **sewer** service to the area in question.

Following the filing of Franklin's answer, Lynnwood moved for partial summary judgment pursuant to Tenn.Code Ann. § 6-51-301, *et seq.* Thereafter, Franklin moved for summary judgment on the grounds (1) that Lynnwood was not entitled to rely on Tenn.Code Ann. § 6-51-101, *et seq.*, (2) that even if Tenn Code Ann. § 6-51-101, *et seq.* were applicable, Lynnwood's damages under Tenn.Code Ann. § 6-51-101 would be zero, (3) that Franklin had complied with Tenn.Code Ann. § 65-4-207 and therefore no legal dispute existed between Franklin and Lynnwood, (4) that Lynnwood had no constitutional taking claim, and (5) that public policy considerations dictate that Franklin be permitted to serve the disputed area without payment of compensation to Lynnwood.

The trial court thereafter took the matter under advisement and, on 29 December 1988, entered an order overruling Lynnwood's motion for partial summary judgment and sustaining Franklin's motion for summary judgment on grounds (1), (2) and (3).

Lynnwood filed a petition to rehear the 29 December 1988 order and moved the trial court to reach the constitutional issues which it had raised in its pleadings and which had arisen because of the nature of Franklin's motion for summary judgment. In conjunction with its petition to rehear, Lynnwood also moved that the Tennessee Attorney General be made party defendant in order to fully bring before the court the issues concerning the constitutionality of Tenn Code Ann. § 6-51-301.

On 7 July 1989, the trial court denied all of Lynnwood's motions Lynnwood has properly perfected its appeal.

The facts pertinent to our inquiry are as follows.

Lynnwood is a privately-owned **sewer** utility company and subject to the rules of the PSC. Tenn.Code Ann. § 65-4-101.

In June 1976, Lynnwood applied for and was

granted a Certificate of Public Convenience and Necessity to serve the Cottonwood Development and Drainage Basin of the Lynnwood Branch in northern Williamson County. Since the issuance of its Certificate, Lynnwood has been operating in its designated service district, providing **sewer** service to a large residential development, as well as other customers within its designated service area. Lynnwood had not extended its system to certain undeveloped areas of its designated service district, but had never refused to do so. Lynnwood has never been requested to provide **sewer** service to these undeveloped areas.

In 1986, Lynnwood petitioned the PSC for an increase in its rates and tap fees. During the hearing on its petition, Lynnwood stated that no new customers were expected in its existing service area. It also developed that Lynnwood did not have any excess capacity in its **sewer** treatment facilities. In order to serve other customers, additional capacity would have been needed.

*2 In the Summer of 1986, Harlon East Properties (Harlon), a Raleigh, North Carolina based land development Company, commenced negotiations with owners of property in northern Williamson County. The property was undeveloped and a large portion of the property was in Lynnwood's utility service district. The property was open farmland owned by three different owners, and only a few persons resided on the property. No part of the property Harlon wished to purchase contained **sewer** mains, pumping stations, treatment stations, **sewer** lines, or any other type of **sewer** equipment.

Harlon planned to develop this property into a residential development to be known as Fieldstone Farms. A portion of Fieldstone Farms is within Lynnwood's service area.

On 28 October 1986, a referendum election regarding whether the land in question would be annexed by Franklin was passed and 1147 acres were annexed into Franklin.

On 12 November 1986, Lynnwood wrote Harlon requesting a meeting to discuss Lynnwood's providing **sewer** services to that portion of Fieldstone Farms located within Lynnwood's designated service area. A copy of the correspondence was sent to Franklin.

On 25 November 1986, Harlon wrote the Mayor of Franklin confirming that the area containing Fieldstone Farms was annexed and acknowledging that Harlon and Franklin had reached a "tentative agreement" that Franklin would provide water and **sewer** services to the annexed area. Harlon requested that Franklin exercise its right to provide water and **sewer** service to the annexed area and also requested Franklin to attempt to reach an agreement with Lynnwood regarding Franklin's providing **sewer** service to Fieldstone Farms.

On 8 December 1986, the Water Committee of the Franklin Board of Mayor and Aldermen unanimously recommended that Franklin provide **sewer** service to the entire newly annexed area.

On 9 December 1986, the Mayor and Board of Aldermen unanimously approved the Water Committee's recommendation with a proviso that Lynnwood be notified of Franklin's intention. The 9 December minutes of the Board do not reflect an election by Franklin to exercise exclusive rights to service the annexed area.

On 14 April 1987, the Franklin Board of Mayor and Aldermen passed a resolution declaring its intention to serve the annexed area and confirming the right of Lynnwood to compete for service pursuant to Tenn.Code Ann. § 65-4-207.

Lynnwood's first issue is:

Does T.C.A. § 6-51-301 provide a right of compensation for a private **sewer** water utility company's right to serve an area when that utility company holds a Certificate of Convenience and Necessity from the Tennessee Public Service Commission where the utility has operated a **sewer** plant in part of the area for many years, and then an adjoining municipality annexes part of the undeveloped area?"

A. Does T C A. § 6-51-301 apply only to a purified water utility company and not to a **sewer** water utility company.

B Does T.C.A. § 6-51-301 apply only where there have been physical improvements laid into the ground by the **sewer** water company, or does the statute apply to the right to serve the service area lost by the utility when part of its overall service

area is appropriated by the municipality through annexation?

*3 For the purposes of this opinion we assume, without holding, that the term "utility water service" in the statute includes **sewer** service and that the **sewer** service provided by Lynnwood comes within the statute.

With that assumption in place, we must determine if Lynnwood, under the undisputed facts, suffered damages as a result of Franklin's election to provide **sewer** service to that portion of the annexed area in which Lynnwood held a Certificate of Convenience and Necessity.

The trial court, in granting Franklin's motion for summary judgment, determined that even if Tenn.Code Ann. § 6-51-301 did apply to a **sewer** utility provider such as Lynnwood, summary judgment was still appropriate since the amount of damages to which Lynnwood would be entitled would not exceed zero under Tenn.Code Ann. § 6-51-301(a)(2) which provides:

Such proceeding [to determine damages] shall be conducted according to the laws of **eminent domain** , Title 29, Ch. 16, and shall include a determination of actual damages, incidental damages, and incidental benefits, as provided for therein, but in no event shall the amounts so determined exceed the replacement cost of the facilities.

Lynnwood concedes that it has no pipes in the ground, that it had constructed no plant, that it has no equipment of any kind, nor has it made any physical addition of any kind in that portion of the area annexed in which it holds a Certificate of Convenience and Necessity. Lynnwood had not constructed its treatment plant so that it has an over capacity as a result of not being able to serve the annexed area.

Lynnwood only has a Certificate of Convenience and Necessity issued by the PSC and has never provided **sewer** services to the annexed area.

Lynnwood contends that the issue is what is meant by the term "facilities" as used in Tenn.Code Ann. § 6-51-301(a)(2). Lynnwood argues that its Certificate of Convenience and Necessity is included within the term "facilities." We respectfully disagree.

We are of the opinion that the term "facilities" as used in Tenn.Code Ann. § 6-51-301(a)(2) means physical facilities, not a right to construct physical facilities and not a right to serve an area. We reiterate that Lynnwood has no physical facilities of any kind in or on the annexed area. Further, it cannot be argued that there has been damage to Lynnwood's physical facilities located outside the annexed area. Lynnwood admitted in the hearing before the PSC that its treatment facilities were not presently built to serve excess customers. In other words, Lynnwood has not constructed its physical facilities in anticipation of serving a larger area.

Our search has not revealed any Tennessee authority, and Lynnwood has not cited any Tennessee Authority, to support its argument that its Certificate of Convenience and Necessity, *i.e.*, its right to serve the annexed area, is a "facility" which is compensable under the statute.

Lynnwood relies on *Hartford Electric Light Co. v. Federal Power Comm'n.*, 131 F.2d 953 (2nd Cir.1942), and *Mississippi Power and Light Co. v. City of Clarksdale*, 288 So.2d 9 (Miss.1973). We are of the opinion that these cases are inapposite to the facts in the case before us

*4 In *Hartford*, the court found that the plaintiff company's contracts, accounts, memoranda, papers and other records utilized in connection with sales constituted facilities for the purposes of the Federal Power Act, 16 U S.C. § 791(a), *et seq.* Here, none of these items are at issue. Franklin has not attempted to assume operating any of Lynnwood's existing facilities, nor has it attempted to acquire any of Lynnwood's accounts, papers, contracts, etc.

In *Mississippi Power and Light Co.*, the statute did not give the municipality the absolute first right to serve upon annexation. The Mississippi statute contained a "grandfather" provision that favored the original service providers. The court therefore deemed the grandfather franchise a "valuable right." We have no such provision in Tenn.Code Ann § 6-51-301.

A Certificate of Convenience and Necessity is not a facility. However, even if we could find that the Certificate of Convenience and Necessity is

included in the term "facilities," Lynnwood has, under the facts and circumstances of this case, damages which do not exceed zero.

When an area is annexed in which an individual or corporation has a Certificate of Convenience and Necessity and the "municipality chooses to render a utility or water services," the holder of the Certificate is entitled to damages but these damages may not "exceed the replacement cost of the facilities." Tenn.Code Ann. § 6-51-301(a)(2) Lynnwood possesses nothing in the annexed area except the Certificate of Convenience and Necessity, *i.e.,* an intangible "right" to provide **sewer** services. As argued by Franklin, payment of the "replacement costs" of items to be transferred makes no sense in the context of an intangible right to provide **sewer** service.

While an intangible right to provide **sewer** services might have some value in the context of the "law of **eminent domain**," Tenn.Code Ann. § 29-16-101, *et seq.,* damages under Tenn.Code Ann. § 6-51-301(a)(2) are limited to replacement costs. There is no replacement cost as contemplated by Tenn.Code Ann. § 6-51-301(a)(2) for an intangible right to provide **sewer** services.

The Chancellor properly granted summary judgment on the ground that the damages Lynnwood suffered did not exceed zero.

In view of our holding under this issue, we deem it unnecessary to address other issues raised by Lynnwood and, therefore, pretermit them.

The judgment of the Chancellor is affirmed with costs assessed to Lynnwood and the cause remanded to the trial court for the collection of costs and any further necessary proceedings.

TODD, P.J., and CANTRELL, J., concur.

1990 WL 38358, 118 P.U.R.4th 288, 1990 WL 38358 (Tenn Ct.App)

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(Cite as: 2003 WL 354466 (Tenn.Ct.App.))

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SEE COURT OF APPEALS RULES 11 AND 12

Court of Appeals of Tennessee.

BELLSOUTH BSE, INC.,
v.
TENNESSEE REGULATORY AUTHORITY.

No. M2000-00868-COA-R12-CV.

Feb 18, 2003

Tennessee Regulatory Authority, No 98-00879

Guilford F. Thornton, Jr., Nashville, Tennessee, for the appellant, Bellsouth BSE, Inc.

Henry Walker, Nashville, Tennessee, for the appellees, MCI WorldCom, Southeastern Competitive Carriers Association, Time Warner Communications of the South, L P , and U.S LEC of Tennessee, Inc.

J. Richard Collier, Jonathan N Wike, Nashville, Tennessee, for the appellee, **Tennessee Regulatory Authority**

PATRICIA J COTTRELL, J., delivered the opinion of the court, in which BEN H CANTRELL , P J , M S , and WILLIAM C KOCH, JR , joined

OPINION

PATRICIA J COTTRELL, J

***1** BellSouth BSE, Inc. appeals from an order of the **Tennessee Regulatory Authority** denying BSE's application for certification as a competing local exchange company in those areas where BSE's affiliate, BellSouth Telecommunications, is the incumbent provider of local services Because the TRA denied the petition on the basis that such certification may be inconsistent with the goal of fostering competition and could be potentially adverse to competition, as opposed to establishing conditions or requirements designed to ensure that anticompetitive practices did not occur, we vacate the order as beyond the agency's statutory authority

Before the state legislature made significant changes in the law governing telecommunications services in 1995, local telephone service was provided to consumers in a locality by one company under a regulated monopoly system. The adoption of the Tennessee Telecommunication Act, 1995 Tenn. Pub Acts 408 (effective June 6, 1995), abolished monopolistic control of local telephone service and opened that market to competition It also changed the way in which providers of such services, and the rates they charge, were regulated

As part of the implementation of local service competition, a company which was providing basic local exchange telephone service, as defined by statute, prior to June 6, 1995, was designated as the "incumbent local exchange telephone company," or ILEC Tenn Code Ann. § 65-4-101(d) New entrants into the market after June 6, 1995, were known as "competing telecommunications service providers" or CLECs. Tenn Code Ann § 65-4-101(e). To become a CLEC, a provider is required to be certificated pursuant to Tenn Code Ann. § 65-4- 201, which provides in pertinent part.

> After notice to the incumbent local exchange telephone company and other interested parties and following a hearing, the authority shall grant a certificate of convenience and necessity to a competing telecommunications service provider if after examining the evidence presented, the authority finds
> (1) The applicant has demonstrated that it will adhere to all applicable authority policies, rules and orders, and
> (2) The applicant possesses sufficient managerial, financial and technical abilities to provide the

applied for services.
Tenn Code Ann. § 65-4-201(c).

BellSouth BSE, Inc. applied for a certificate as a CLEC (First Application) to provide local telephone services on a statewide basis BellSouth BSE, Inc. is a wholly owned subsidiary of BellSouth BSE Corporation which, in turn, is a wholly owned subsidiary of BellSouth Corporation BellSouth Telecommunications ("BST"), another wholly-owned subsidiary of BellSouth Corporation, is the incumbent local exchange provider for portions of Tennessee. The **Tennessee Regulatory Authority** ("TRA") granted BellSouth BSE, Inc ("BSE") authority to provide local services only in those territories where its affiliate, BST, was not the ILEC The TRA concluded that the potential for anticompetitive harm outweighed the benefits to consumers if BSE were permitted to operate as a CLEC in those areas where its affiliate was providing local service as the ILEC

***2** BSE, however, was invited to re-open the issue if at any time in the future it believed it could "carry the public interest burden herein raised and alleviate the Agency's concerns with regard to Tenn Code Ann § 65-5- 208(c).. ." BellSouth BSE, Inc did just that and sought expanded authority to operate as a CLEC (Second Application). Competitors were allowed to intervene, [FN1] and a hearing was held The TRA denied the petition. It is that denial which is the subject of this appeal

> FN1 The intervenors who are also appellees in this appeal are MCI WorldCom, Inc , Southeastern Competitive Carriers Association, Time Warner Telecom of the Mid-South, L P , and U S LEC of Tennessee, Inc

BSE did not propose to offer any services that could not be offered by BST. BSE intended to provide "any and all services that are or may be provided by a local exchange carrier "

I. The TRA's Concerns

In denying BSE's application for a certificate of convenience and necessity to provide expanded intrastate telecommunications services, the TRA recounted that the Second Application proceedings were held to provide BSE the opportunity to alleviate the concerns which led to the TRA's order on the First Application Those concerns are related to the potential for anticompetitive behavior and the potential for BST to avoid controls imposed upon it because of its status as an ILEC, as well as its status under federal law as a "Bell operating company," through the use of an affiliate. The TRA expressed several specific areas of concern, which can only be examined in the context of the regulatory framework, both state and federal, for telecommunication services providers.

By enactment of the Telecommunications Act of 1996, Congress made fundamental changes in local telephone markets by, among other things, prohibiting states from enforcing laws that impede competition. In order to facilitate the transition from regulated monopolies to true competition, the Act imposes upon the incumbent provider or ILEC, who formerly enjoyed the monopoly, a number of duties intended to facilitate entry into the market by other, formerly excluded, providers. *AT & T Corp. v. Iowa Utils Bd*, 525 U.S. 366, 371-72, 119 S Ct. 721, 726-27 (1999). As more specifically explained:

> Until the passage of the 1996 Act, state utility commissions continued to regulate local telephone service as a natural monopoly Commissions typically granted a single company, called a local exchange carrier (LEC), an exclusive franchise to provide telephone service in a designated area Under this protection the LEC built a local network--made up of elements such as loops (wires), switches, and transmission facilities--that connects telephones in the local calling area to each other and to long distance carriers.
>
> The 1996 Act brought sweeping changes. It ended the monopolies that incumbent LECs held over local telephone service by preempting state laws that had protected the LECs from competition *See* 47 U S C. § 253. Congress recognized, however, that removing the legal barriers to entry would not be enough, given current technology, to make local telephone markets competitive. In other words, it is economically impractical to duplicate the incumbent LEC's local network infrastructure To get around this problem, the Act allows potential competitors, called competing local exchange carriers (CLECs), to enter the local telephone

market by using the incumbent LEC's network or services in three ways First, a CLEC may build its own network and "interconnect" with the network of an incumbent *See id* § 251(c)(2). Second, a CLEC may lease elements (loops, switches, etc) of an incumbent LEC's network "on an unbundled basis " *See id.* § 251(c)(3) Third, a CLEC may buy an incumbent LEC's retail services "at wholesale rates" and then resell those services to customers under its (the CLEC's) brand *See id.* § 251(c)(4).

*3 *GTE South, Inc. v. Morrison,* 199 F.3d 733, 737 (4th Cir 1999)

This access is accomplished through an interconnection agreement between the ILEC and a CLEC. In addition, an ILEC is required to provide access to its network elements and various services and to provide dialing parity to competing providers on a nondiscriminatory basis. 47 U.S.C §§ 251(c)(3) & 251(b)(3) The FCC has promulgated rules and policies implementing those provisions "to require incumbent LECs to provide competition with access to the incumbent LECs' networks sufficient to create a competitively neutral playing field for new entrants. .." *In Re Implementation of the Telecommunications Act of 1996, Third Report and Order* in CC Docket No 96-115, *Second Order on Reconsideration of the Second Report and Order* in CC Docket No. 96-98, and *Notice of Proposed Rulemaking* in CC Docket No 99-273, at ¶ 6 (rel. Sept. 9, 1999).

Under state law, all providers are required to provide non-discriminatory interconnection to their public networks under reasonable terms and conditions, and all are to be provided "desired features, functions and services promptly, and on an unbundled and non-discriminatory basis from all other telecommunications providers " Tenn Code Ann § 65-4-124(a)

At the state level, incumbent providers are also governed by specific provisions, again designed to facilitate entry into the local telephone service market by competitors For example, rates to be charged by incumbent providers opting to be under a price regulation plan are subject to a requirement that such rates be just and reasonable, defined as "affordable", as determined by the TRA. Tenn Code Ann § 65-5-209(a). These rates are subject to limitations, including safeguards to ensure universal service and nondiscrimination among customers. Tenn Code Ann. § 65-5-209(b)

After the initial qualification of a price regulation plan, an ILEC's ability to increase rates is subject to limitations. Essentially, a price regulated ILEC can adjust rates for specific services subject to an overall maximum annual adjustment to aggregate revenues for such services Tenn Code Ann § 65-5-209(e) However, rates for basic services cannot be increased for four (4) years after implementation of the plan, and annual increases for basic services are thereafter limited to annual rates of inflation Tenn.Code Ann. § 65-5- 209(f)

ILECs not under a price regulation plan are subject to traditional rate regulation. ILECs have unique, carrier-of-last-resort obligations and universal service obligations Tenn Code Ann § 65-5-207(c)(2) & (8) ILECs, upon request, are required to provide interconnection services to CLECs. Tenn Code Ann. § 65-5-209(d). None of these burdens apply to CLECs.

Another requirement for ILECs which was the subject of argument herein and part of the TRA's reasoning is that found in Tenn.Code Ann. § 65-5-208(c), which provides·

Effective January 1, 1996, an incumbent local exchange telephone company shall adhere to a price floor for its competitive services subject to such determination as the authority shall make pursuant to § 65-5-207. [FN2] The price floor shall equal the incumbent local exchange telephone company's tariffed rates for essential elements utilized by competing telecommunications service providers plus the total long-run incremental cost of the competitive elements of the service. When shown to be in the public interest, the authority shall exempt a service or group of services provided by an incumbent local exchange telephone company from the requirement of the price floor. **The authority shall, as appropriate, also adopt other rules or issue orders to prohibit cross-subsidization, preferences to competitive services or affiliated entities, predatory pricing, price squeezing, price discrimination, tying arrangements or other anti-competitive practices.**

> FN2. Tenn Code Ann. § 65-5-207 authorizes the TRA to establish policies, rules, and orders requiring all telecommunications service providers to contribute to the support of universal service, which consists of residential basic local exchange telephone service at affordable rates and carrier-of-last-resort obligations

***4** (emphasis added).

It is the highlighted language which provides the primary basis for the TRA's denial of BSE's application for CLEC status in those areas where its affiliate is the incumbent provider. The TRA expressed concerns that the relationship between BSE and BST fostered the potential for the enumerated, or other, anticompetitive activities, as well as the opportunity for BST to avoid the limitations placed on it as an ILEC The six concerns, or issues for resolution, expressed by the TRA were:

1. Whether there exists the potential for discriminatory treatment of other CLECs or for preferential treatment of BSE by BellSouth when there are no safeguards being offered to monitor affiliate transactions or performance;
2. Whether BellSouth seeks to avoid its ILEC obligations through BSE's ability to select BellSouth's best customers and offer special deals that BellSouth cannot offer due to statutory prohibitions;
3 Whether there exists the potential for the prohibited acts of price squeezing and cross-subsidization,
4. Whether in the solicitation of BellSouth business customers by BSE, those customers will continue to be offered the same services under the same utility's name, with the same personnel over the same local network as employed by BellSouth,
5. Whether BSE presented substantial and material evidence that it would provide services to consumers that could not be offered by BellSouth; and
6 Whether it is in the public interest for a Regional Bell Operating Company ("RBOC") such as BellSouth, to have an affiliated CLEC operating within its territory

The last issue involves BellSouth's status as a RBOC, and that issue again requires some background explanation In 1974, the U.S. Department of Justice brought an antitrust action against AT & T for monopolization of telecommunications services and equipment *United States v. American Tel and Tel Co.*, 552 F.Supp. 131 (D.D.C.1982), *aff'd sub nom Maryland v United States,* 406 U S. 1001, 103 S Ct. 1240 (1983)

That long and complex litigation resulted in a settlement reflected in a consent decree This consent decree required AT & T to divest itself of the twenty or so Bell operating companies ("BOCs") that provided local telephone service as monopolies Under the court-approved plan, these BOCs were spun off from AT & T and grouped into seven regional holding companies, or RBOCs, who continued to provide local service as regulated monopolies until the 1996 Telecommunications Act and/or similar legislation in various states. *See AT & T Corp. v. Federal Communications Comm'n,* 220 F.3d 607, 611 (D C Cir.2000). Bell South is a RBOC. *Id ; see also* 47 U.S C § 153(4) (defining "Bell operating company" by listing twenty companies by name, including South Central Bell Telephone Company, the predecessor of BST). Although the Bell operating companies were allowed to retain their state-regulated monopolies on local service, they were prohibited by the consent decree from entering other parts of the telecommunications business, including long distance, equipment sales, and specified other services. *United States v. American Tel. and Tel. Co* , 552 F.Supp. at 224

***5** The Telecommunications Act of 1996 rescinded the consent decree. While a number of key provisions apply to all incumbent local exchange carriers, such as the requirement that they offer nondiscriminatory access and interconnection to local competitors, 47 U S C § 251, the Act also includes "Special Provisions Concerning Bell Operating Companies," 47 U S C §§ 271 to - 276, which apply only to the BOCs and their affiliates. Some of these provisions allow BOCs to enter into formerly prohibited areas of the telecommunications market, but only under specifically enumerated conditions Of primary importance, § 271 establishes requirements that a BOC or its affiliate must meet before it can provide long distance, or InterLATA, services Those requirements relate primarily to interconnection and include a competitive checklist insuring, among other things, nondiscriminatory access to network

elements and other facilities and services 47 U.S C. § 271(c). [FN3]

> FN3 The Act further provides that the FCC cannot approve a BOC or BOC affiliate application to provide interLATA services unless it finds that the applicant has met the requirements with respect to access and interconnection, has fully implemented the competitive checklist, "the requested authorization will be carried out in accordance with the requirements of section 272," and the approval is consistent with the public interest, convenience and necessity 47 U S C. § 271(d)(3).

BOCs and their affiliates are barred from manufacturing and selling equipment until they have received authorization to provide interLATA services, which, of course, requires demonstrated compliance with the nondiscriminatory access requirements and the competitive checklist 47 U.S.C § 273 That section includes additional strictures on such manufacturing activities Section 276 includes nondiscrimination safeguards for provision of payphone services by a BOC and a requirement that a BOC may not subsidize its payphone services directly or indirectly from its telephone exchange service operations. In addition, BOCs may provide electronic publishing only through a separate affiliate or through a joint venture operated according to specific requirements, including structural separation 47 U S C. § 274. [FN4]

> FN4. This required structural separation, or line-of-business restriction, has been upheld in a bill of attainder and first amendment challenge. *BellSouth Corp. v. F C.C.,* 144 F 3d 58, 61 (D C Cir 1998), *cert denied,* Apr 26, 1999

Most relevant to our analysis of the issues herein, because of the parties' references to and arguments about "Section 272 affiliates" is the requirement of 47 U.S C. § 272, which the FCC has described as follows·

> Section 272(a) provides that a BOC (including any affiliate) that is a LEC subject to the requirements of section 251(c) may provide certain services only through a separate affiliate Under section 272, BOCs (or BOC affiliates) may engage in the following activities only through one or more affiliates that are separate from the incumbent LEC entity· (A) manufacturing activities; (B) interLATA telecommunications services that originate in-region; and (C) interLATA information services

In the Matter of Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, As Amended, CC Docket No 96-149, First Report and Order, at ¶ 50 (rel. Dec. 24, 1996) (footnotes omitted).

The statute establishes "structural and transactional requirements" for § 272 separate affiliates, including independent operation, maintenance of separate books and records, totally separate officers, directors and employees, and no credit arrangement whereby recourse may be had against the assets of the BOC. 47 U.S.C. § 272(b)(1)-(4). In addition, the affiliate is required "to conduct all transactions with the Bell operating company of which it is an affiliate on an arm's length basis with any such transactions reduced to writing and available for public inspection " 47 U.S.C § 272(b)(5). Nondiscrimination safeguards also exist 47 U.S C § 272(c)

***6** It is this structural and operational separation between the BOC and its affiliate which has been determined on the federal level to provide protection against anticompetitive practices. It allows a BOC affiliate to provide some services that the BOC itself would be prohibited from providing This separation is a critical element in understanding the TRA's position herein.

II. ILEC Affiliation

The TRA has previously granted certificates to over thirty competing local exchange carriers to provide local services on a statewide basis In addition, the TRA has granted certificates as CLECs to two affiliates of ILECs, namely Citizens Telecommunications Company of Tennessee and United Telephones-Southeast, Inc [FN5] BSE asserts that these prior approvals establish

precedent which the TRA must follow and require that BSE's statewide application be granted because the TRA is required by federal and state law to certificate CLECs on a competitively neutral basis

> FN5. At BSE's request, at the hearing involved herein the TRA took judicial notice of its grant of these certificates, and the records from those proceedings have been included in the record herein. Those records reflect that the TRA granted to Sprint Communications Company, L P. a certificate to provide intrastate service based upon an application to provide a full array of telecommunications services normally provided by an incumbent local exchange telephone company throughout the State of Tennessee in all geographic locations permitted under Tenn Code Ann § 65-4-201. Similarly, Citizens Telecommunications Company filed an application for certification as a CLEC seeking authority to operate statewide to provide a full array of telecommunications services as would normally be provided by an incumbent local exchange telephone company The TRA granted the application

The TRA responds that its prior decisions, involving other companies in other situations, do not bind it in this situation It also asserts, and found, that BellSouth and its affiliate BST or BellSouth are different from other CLECs and their affiliates and present unique issues The TRA found:

> In Tennessee, Citizens, Sprint, and their affiliated companies are not similarly situated to BellSouth and BSE Neither Citizens nor Sprint are RBOCs, and neither possesses the historical market dominance so closely associated with RBOCs such as BellSouth Unlike Citizens and Sprint, BellSouth maintains approximately eighty percent (80%) of the access lines in Tennessee. Therefore, since BSE is the affiliate of the dominant local exchange carrier in Tennessee, the actions which BSE seeks to take must be evaluated by assessing whether such actions will truly foster competition in Tennessee. The authority finds that Citizens and Sprint are not similarly situated to BSE and BellSouth.

(footnotes omitted)

If the TRA had determined that BSE was ineligible to be certified statewide as a CLEC on the basis that an affiliate was disqualified from certification in the same market where its affiliate was the incumbent provider, the two prior approvals would pose serious problems to affirming the TRA's order herein However, the TRA did not find that such a *per se* disqualification existed, and we can find none in the statute The prior approvals indicate that the TRA interpreted the Telecommunications Act as authorizing affiliates of ILECs to be certified as CLECs statewide, including in those markets where the affiliate was the incumbent.

The prior approvals also serve to rebut an argument made herein by the intervenors. Those intervenors argue that it is illegal under Tennessee law for BellSouth to operate as both an ILEC and a CLEC in the same service territory They assert that because the Telecommunications Act defines a CLEC as a carrier providing service before June 6, 1995, and defines an ILEC as a provider of services certified after June 6, 1995, an ILEC cannot be a CLEC. We do not disagree that the statute envisions an ILEC and a CLEC as being different entities.

***7** However, the intervenors argue that because BST cannot be a CLEC, BellSouth should not be allowed to accomplish the same illegal result through use of an affiliate; i.e , BST cannot do indirectly what it is prohibited from doing directly While much of the intervenors' argument is addressed to BellSouth's market dominance and position, their argument is also based upon the statutory distinctions between ILECs and CLECs To that extent, the intervenors' assertions that BellSouth cannot operate both an ILEC and a CLEC would apply equally to any other affiliate relationship. Obviously, the TRA has rejected that interpretation of the statute by certifying as CLECs at least two other entities affiliated with ILECs We find no basis for rejecting the TRA's interpretation. In fact, the legislature apparently foresaw the possibility of an ILEC providing services to an "affiliated entity" *See* Tenn Code Ann. § 65-5-208(c).

As the TRA's order makes clear, its denial of BSE's request for a certificate for statewide CLEC status

was not based upon BSE's status as an affiliate of an ILEC *per se* Instead, it was related to the unique position enjoyed by BellSouth as the dominant provider of local exchange services and as a Bell operating company.

We agree with the TRA that each application must be considered on its own merits and upon the facts of each individual situation In the instant situation, the facts raise issues as to the effect of certification on competition which may differ from those raised by other incumbent affiliate applications. However, the TRA cannot apply legal requirements arbitrarily or capriciously and must have a factual basis for its actions Tenn.Code Ann. § 4-5-322(h).

III BOC Status

As set out earlier, BellSouth, BST and BSE (as an affiliate of a BOC) are subject to specific provisions of the Telecommunications Act of 1996 not applicable to other CLECs The question is whether that status justifies a differing approach or standard for BSE's qualification as a CLEC than that applied to affiliates of other ILECs who are not also BOCs

BSE argues that the FCC has recognized or authorized affiliates of ILECs and BOCs. The TRA has acknowledged and referred to the FCC's rulings on specific arrangements, but has distinguished the situation covered by those rulings from the situation presented by BSE's application herein

The FCC has considered the question of the provision of local exchange and exchange access by Section 272 BOC affiliates and reached the following conclusion:

> Based on our analysis of the record and the applicable statutory provisions, we conclude that section 272 does not prohibit a section 272 affiliate from providing local exchange services **in addition to** interLATA services, nor can such a prohibition be read into this section Specifically, section 272(a)(1) states that--
>
> A Bell operating company (including any affiliate) which is a local exchange carrier that is subject to the requirements of section 251(c) may not provide any service described in [section 272(a)(2)] unless it provides that service through one or more affiliates that . are separate from any operating company entity that is subject to the requirements from section 251(c) .
>
> ***8** We find that the statutory language is clear on its face--a BOC section 272 affiliate is not precluded under section 272 from providing local exchange service, **provided that the affiliate does not qualify as an incumbent LEC subject to the requirements of section 251(c).**

In the Matter of Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, As Amended, CC Docket No 96-149, First Report and Order, at ¶ 312 (rel Dec 24, 1996) (emphasis added)

It is clear that the FCC's comments are addressed to those BOC affiliates which are Section 272 affiliates and are operated independently from an ILEC affiliate. They apply where the BOC incumbent has been authorized to provide long distance services. This means that the BOC incumbent has demonstrated to the FCC's satisfaction that it has complied with the various competition requirements set out in 47 U.S.C § 271

We agree with the TRA that the FCC rulings relied upon by BSE do not directly apply to an application by an affiliate of a BOC which is not a Section 272 affiliate to provide local service in an area where the BOC is the incumbent. While BSE is not incorrect in asserting that these FCC rulings do not prohibit the grant of its application, they also do not require it. The FCC, based on federal statutory law, has found that BOC affiliates may provide certain kinds of services when circumstances not present in the case before us exist

BSE is not a Section 272 affiliate, and does not claim to be. Section 272 affiliate status only applies to affiliates of a BOC which have received Section 271 approval The TRA determined that BSE "remains a type of affiliate not contemplated under § 272." In addition, the TRA explained

> It is appropriate that BSE has not requested in its Application to provide non-incidental services, because BSE cannot satisfy the requirements for a Section 272 affiliate, for those services, until interLATA permission is granted pursuant to Section 271 The Authority concludes that BSE cannot, at this time, as a matter of law, provide Section 272(a)(2) non-incidental services, does not intend to provide Section 272(a)(2) incidental services, and is, therefore, not a Section 272 affiliate Having concluded as such it is difficult

> to embrace the position that the safeguards established under Section 272 are applicable to BSE. It is equally difficult to accept that an entity such as BSE is of the type contemplated by the FCC's pronouncement that Section 272 does not prohibit a Section 272 affiliate from providing local exchange services in addition to interLATA services
> (footnotes omitted).

The TRA asserts that BSE's lack of Section 272 status is important is considering the competitive goals of both federal and state legislation. The Authority contends that Section 271 approval indicates satisfaction of the requirements for entry into the long distance market, including compliance with the competitive checklist As of the date of the proceedings herein, BellSouth did not have Section 271 approval, and the TRA states that BellSouth has been denied that approval several times by the FCC and in other states [FN6] Consequently, the TRA found that BSE had not been required to show that it has adequate operations support systems with performance measurements in place which would "provide assurance that the public welfare is protected by ensuring that competing carriers have a means to compete and are treated in a competitively neutral manner by the ILEC [BST]." The TRA also found that not only does the denial of such approval indicate that the required proof of compliance with competitive safeguards was not provided in those proceedings, the TRA found that BSE did not demonstrate such compliance in the hearing herein.

> FN6. For example
> *In the Matter of Application of BellSouth Corporation, et al., Pursuant to Section 271 of the Communications Act of 1934, as amended, to Provide In-Region, InterLATA Services in South Carolina,* 13 FCC Rcd 539, 547 P 14 (1997) (failure to (1) provide nondiscriminatory access to operations support systems, (2) provide unbundled network elements in a manner that permits competing carriers to combine them through collocation, and (3) offer certain retail services at discounted rates), *aff'd, BellSouth Corp v. FCC,* 333 U S App D C 253, 162 F 3d 678 (D C Cir 1998); *In the Matter of Application by BellSouth Corporation, et al., Pursuant to Section 271 of the Communications Act of 1934, as amended, to Provide In-Region, InterLATA Services in Louisiana,* 13 FCC Rcd 6245, 6246-47 P 1 (1998) (failure to provide nondiscriminatory access to operations support system and to make telecommunications services available for resale), *In the Matter of Application of BellSouth Corporation, BellSouth Telecommunications, Inc, and BellSouth Long Distance, Inc., for Provision of In-Region, InterLATA Services in Louisiana,* 13 FCC Rcd 20599, 20605 P 10 (1998) (failure to provide nondiscriminatory access to operations support system and unbundled network elements).
> *AT & T Corp v. FCC,* 220 F.3d at 613

***9** The TRA did not deny the application for statewide CLEC certification because of BSE's status as a BOC or BOC affiliate. It did, however, consider that status as a factor in its consideration of the competitive effect of allowing BSE to compete with its affiliate where the competition protections assured by Section 272 affiliate status are not present. We conclude that neither BSE's status as an ILEC affiliate nor its status as a BOC affiliate was the basis for the TRA's denial That status did, however, influence the standards applied by the TRA to BSE in its consideration of the competitive effect of granting BSE's application.

IV The Issues Presented and The Standard of Review

As the list of TRA concerns set out earlier in this opinion demonstrates, the TRA focused its decision on the potential for anticompetitive activities and conduct if an affiliate of the Regional Bell Operating Company and ILEC were certified as a CLEC, especially in the absence of the protections provided by federal law to Section 272 affiliates In the order now under appeal, the TRA noted that in its previous denial "one critical area of concern was that the affiliate relationship between BST and BSE could be potentially and irreversibly adverse to competition " The TRA found without Section 271 approval of BellSouth, there was still no evidence that BellSouth had the necessary safeguards in place

to ensure fair treatment among all CLECs and further stated

> Exacerbating our concern is that no other performance measurements have been established, which arguably help to serve as support to the existence of competitive neutrality in the relationship between BellSouth, BSE and other CLECs. Without these safeguards and measurements the Authority would have difficulty determining whether BellSouth in fact afforded preferential treatment to its affiliate CLEC in Tennessee.

It was on the basis of these concerns that the TRA determined that approval of BSE's application was not in the public interest and "may, in fact" be inconsistent with the goal of competition. The TRA concluded that BSE offered little convincing evidence or testimony to diminish its concerns regarding potentially abusive collusive behavior.

On appeal, our review of the TRA's order is governed by Tenn.Code Ann § 4- 5-322(h), which provides·

> 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) Unsupported by evidence which is both substantial and material in the light of the entire record
>
> ***10** 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 TRA may exercise only that authority given it expressly by statute or arising by necessary implication from an express grant *BellSouth Adver & Publ'g Corp v Tennessee Regulatory Auth*, 79 S W 3d 506, 512 (Tenn 2002); *Tennessee Pub Serv. Comm'n v. Southern Ry Co*, 554 S W 2d 612, 613 (Tenn.1977). The General Assembly has given the TRA "practically plenary authority over the utilities within its **jurisdiction**." *BellSouth Adver. & Publ'g Corp*, 79 S.W.3d at 312 (quoting *Tennessee Cable Television Ass'n v Tennessee Pub. Serv. Comm'n*, 844 S.W 2d 151, 159 (Tenn Ct .App 1992)) The TRA has "general supervisory and regulatory power, **jurisdiction**, and control over all public utilities" Tenn Code Ann § 65-4-104. The General Assembly has given the TRA, in addition to other **jurisdiction** conferred, the authority to "investigate, hear and enter appropriate orders to resolve all contested issues of fact or law arising as a result of the application of Acts 1995, ch 408 [the Tennessee Telecommunications Act]" Tenn Code Ann § 65-5-210(a).

BSE asserts, however, that the TRA's order was contrary to governing statutory provisions In reviewing BSE's request, the TRA was required to apply Tenn Code Ann § 65-4-201(c), quoted earlier, which establishes the requirements for certification as a competing provider BSE asserts that it met the two requirements by demonstrating (1) that it will adhere to all applicable TRA policies, rules and orders; and (2) that it possesses managerial, financial and technical abilities to provide the services. BSE cites the TRA's approval of it as a CLEC in some territories in Tennessee as proof the TRA has found that BSE meets these statutory qualifications Accordingly, BSE argues, the TRA was required to grant its application for statewide certification because of the mandatory language of the statute.

There is no dispute that BSE met the two requirements of Tenn.Code Ann § 65-4-201(c) The TRA, however, determined that its other statutorily assigned responsibilities required it to examine the application in light of its effect on competition, including its responsibility under Tenn Code Ann § 65-4- 201(a) to consider the present and future public interest in determining whether to grant a certificate of convenience and necessity. In the case herein, however, the TRA defined that public interest in terms of the impact of BSE's application on competition It is clear from the order that the TRA's reason for denying BSE certification as a CLEC in those areas where its affiliate was the ILEC was its determination that such certification could adversely impact the

development of competition in the provision of local telephone service.

*11 The TRA maintains that it was required to consider the effect on competition. The TRA relied upon its obligations set out in Tenn Code Ann § 65-5-208(c), also quoted above, to prohibit anticompetitive practices in dealings between the incumbent and competitors The TRA was also mindful of the General Assembly's policy of fostering competition, as set out in the Tennessee Telecommunications Act of 1995.

> The general assembly declares that the policy of this state is to foster the development of an efficient, technologically advanced, statewide system of telecommunications services by permitting competition in all telecommunications services markets, and by permitting alternative forms of regulation for telecommunications services and telecommunications services providers. To that end, the regulation of telecommunications services and telecommunications services providers shall protect the interests of consumers without unreasonable prejudice or disadvantage to any telecommunications services provider, universal service shall be maintained, and rates charged to residential customers for essential telecommunications services shall remain affordable.

Tenn.Code Ann. § 65-4-123 In the preamble to the Tennessee Telecommunications Act, the General Assembly stated a policy that "Competition among providers should be made fair by requiring that all regulation be applied impartially and without discrimination to each " 1995 Tenn Pub. Acts ch. 408.

In addition, federal law places a duty on the TRA to promote or insure competition in the provision of telecommunication services. In particular, the Telecommunications Act of 1996 requires removal of barriers to entry into that business and states.

> (a) In general No State or local statute or regulation, or other State or local legal requirement, may prohibit or have the effect of prohibiting the ability of any entity to provide any interstate or intrastate telecommunications service.
>
> (b) State regulatory authority Nothing in this section shall affect the ability of a State to impose, on a competitively neutral basis and consistent with Section 254 of this title, requirements necessary to preserve and advance universal service, protect the public safety and welfare, ensure the continued quality of telecommunications services, and safeguard the rights of consumers.

47 U.S C § 253

We agree with the TRA that it has the authority to consider the effect on competition of an application for statewide certification as a CLEC In addition to its general almost plenary authority to regulate public utilities and the authority granted by the statutes quoted herein, it also has specific authority to adopt rules or issue orders to prohibit anticompetitive practices Tenn Code Ann § 65-5-208(c). Thus, we conclude the TRA did not act in excess or in contravention of relevant statutory authority in considering the effect on competition.

However, the authority to consider the effect on competition does not remove the requirements that the agency base its decisions on substantial and material evidence and that those decisions not be arbitrary or capricious The determinative issues in this appeal are framed by BSE's arguments that the TRA's decision was arbitrary because it differentiated among ILEC affiliates and that the decision was based upon speculation and not upon the evidence and, therefore, is not supported by substantial and material evidence In addition, BSE asserts that the TRA's order is actually anticompetitive and prevents BSE's entry into the market as a competing local exchange service provider by establishing more stringent requirements for it than those applied to other ILEC affiliates The intervenors assert that BST is already dominant in the local services market, making removal of barriers to entry irrelevant The TRA asserts its order was designed to further the competition envisioned by both federal and state law.

*12 The TRA did, in fact, treat BSE's application differently from applications for statewide CLEC certification other affiliates of ILECs They based this differing treatment on BSE's relationship to BellSouth, which has undisputed market dominance in the state and which is a BOC Regional Bell Operating Companies have been subject to strictures and limitations not applicable to other

companies since the consent order was entered in *United States v American Tel and Tel. Co* The 1996 Telecommunications Act has special provisions relating to RBOCs. Because RBOCs had gained control of the local services markets through a monopoly, such measures were considered necessary if true competition were to develop as a practical matter.

The FCC has recognized the authority of state regulatory agencies to treat certain BOC related entities differently because of the potential impact on competition

> State regulation As mentioned above, several BOCs have already submitted applications to state regulatory commissions seeking authority to provide both local exchange services and interLATA services from the same affiliate Although we conclude that the 1996 Act permits section 272 affiliates to offer local exchange service in addition to interLATA service, we recognize that individual states may regulate such integrated affiliates differently than other carriers. [FN7]
>
> > FN7 BSE's application does not include a proposal to provide interLATA (long distance) services. As discussed earlier, the FCC's pronouncements have involved Section 272 affiliates who propose to provide both local and long distance services. Thus, in our earlier discussion of BOC status, we have agreed with the TRA that the FCC's recognition of BOC and ILEC affiliates is not dispositive of the question of whether an affiliate which is not a Section 272 affiliate may qualify as a CLEC where its affiliate is the ILEC. However, while the finding that state regulatory agencies may regulate integrated affiliates differently from other entities is not directly applicable to a non-272 affiliate becoming a CLEC, we think the principles involved are similar enough to warrant reliance on the FCC's recognition of state agencies' authority to regulate BOC affiliates differently.

In the Matter of Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, As Amended, CC Docket No 96-149, First Report and Order, at ¶ 317 (rel. Dec 24, 1996) (footnotes omitted)

Although state statues do not make reference to RBOCs, we conclude that the TRA had the authority to consider BellSouth's market dominance in the state and its status as a BOC in analyzing the competitive effects of its affiliate's application We also conclude that Tenn Code Ann § 65-5-208(c) gave the TRA the authority to issue orders which would prohibit the specific anticompetitive practices listed in the statute, as well as others. Because the relationship between BST, BSE, and BellSouth provides a situation where such practices can develop, the TRA was authorized to examine this situation differently from other applications and to adopt rules or to establish by order standards or requirements to fulfill its responsibility to further competition.

However, that is not what the TRA did Instead of "regulating" a BOC affiliate differently, the TRA denied the certification BSE describes the TRA's decision as "Rather than engage with BSE in a reasonable framework of regulation for its services in the market, the TRA has chosen to simply deny BSE a place at the table." The question is whether the TRA could deny certification under the facts presented

V.

The TRA had previously expressed its concerns about the potential for anticompetitive conduct between BSE and its affiliates. The second hearing was held to allow BSE to address those concerns In the hearing, BSE offered to submit itself to various requirements to alleviate the concerns of the TRA. In specific, BSE offered:

***13** (1) To operate independently from BST;

(2) To maintain its books, records, and accounts separate from the books, records, and accounts maintained by BST;

(3) To have separate officers, directors, and employees from BST,

(4) Not to obtain credit under any arrangement that would permit a creditor, upon default, to have recourse to the assets of BST,

(5) To conduct all transactions with BST on an arms' length basis with any such transactions reduced to writing and available for public

inspection, [FN8]

> FN8 Items 1-5 replicate the structural separation requirements set out in 47 U.S.C. § 272(b).

(6) Not to engage in cross-subsidization, granting preferences to competitive services or affiliated entities, predatory pricing, price squeezing, price discrimination, tying arrangements, or other anticompetitive practices as prohibited by Tenn Code Ann § 65-5-208(c);
(7) To set its price floor equal to the wholesale price it pays to BST;
(8) To file and resell its Contract Service Agreements;
(9) To be bound by the non-discrimination requirements of 47 U S C. §§ 251 and 252,
(10) To file tariffs,
(11) To consent to regular audits of its operations by the TRA;
(12) To provide cost allocation data of its operations;
(13) To accept advertising restrictions assuring that any advertising would properly identify "BellSouth BSE";
(14) To submit to any other applicable ILEC Rules in the event BSE undertakes the activities of its ILEC affiliate BST; and
(15) To abide by any and all of the applicable TRA policies, rules and orders

The TRA found these promises insufficient, primarily for three reasons It determined that BSE's failure to file a cost allocation manual prevented the Authority from determining whether appropriate safeguards were in place to prevent cross-subsidies between regulated and non-regulated services [FN9] Similarly, BSE did not file a business plan, and the TRA stated it routinely examined such plans when considering CLEC applications The TRA found that "The lack of a business plan and cost allocation manual prevents the Authority from determining the extent to which BSE intends to operate, and whether such operation and the provisioning of telecommunications services on an expanded level is compatible with the public interest "

> FN9. There is proof in the record that with regard to BSE's operation in the Tampa, Florida area, cost allocations between BSE and BellSouth's cellular phone company were not very strict, even though the companies shared some costs. For example, the cellular provider paid all advertising costs, and BSE did not pay a portion of that

Although BSE did not file a business plan, an Intervenor introduced into evidence a report prepared for BellSouth by a consultant regarding the benefits to BellSouth of sending a CLEC affiliate into various markets BSE disavowed the report, stating that it did not serve as BSE's business plan In its brief, the TRA argues the report is "significant, not as a representation of BSE's current or future business practices, but for its indication of the most obvious opportunities that a CLEC affiliate would provide for BellSouth and for the fact that BellSouth was studying these opportunities in great detail " The brief continues·

> The report is replete with statements that BellSouth viewed its "CLEC" as an extension of BellSouth, which would benefit from maximum identification with BellSouth, that the CLEC would be operated as part of a comprehensive business strategy that would pertain to all BellSouth companies, and that the CLEC would offer many ways of circumventing regulatory restraints on BellSouth's incumbent LEC operations. . Elsewhere, the report states that the rationale for establishing a CLEC is that "BellSouth needs alternatives to gain pricing and packaging freedoms."

***14** We do not disagree with the TRA's description of the report. Although BSE denied the report was ever its business plan, the TRA argues that "The existence of this report submitted by the Intervenors and the absence of a business plan from BSE creates a reasonable presumption that BST intended to let loose its affiliate 'CLEC' upon the market not as a truly independent competitor and in order to circumvent regulatory requirements."

The final, and apparently most significant, reason given by the TRA is its interpretation of BSE's offer to be bound by a price floor equal to the resale price it pays to BST for the purchase of its telecommunications services. As discussed above, Tenn Code Ann. § 65-5-208(c) requires an ILEC to adhere to a price floor for its competitive services which must equal the ILEC's rates for essential

services used by CLECs plus the total long-run incremental cost of the competitive elements of the service.

One of the major concerns of the intervenors was the price floor issue. On appeal, they argue that Tennessee has established a "price floor" for certain ILEC services and prohibited the ILEC from charging customers less than that amount for the purpose of preventing ILECs from engaging in predatory pricing, *i e.*, pricing services below cost. The intervenors' expert testified that the price floor statute prevents an incumbent provider with market power from pricing services at less than cost and thereby discouraging potential competitors from building their own networks. Essentially, the intervenors argue that since an ILEC is restricted by law to a price floor, the same public policy requires that an affiliate of an ILEC be subject to the same restriction because the ILEC should not be allowed to avoid the statutory price floor by operating through an affiliate. [FN10]

> FN10. The intervenors' position is explained in their brief as follows
> Based on the testimony at the second hearing, here is how BSE's scheme would work: Under federal law, BellSouth is required to make all services available for resale at a discounted, wholesale rate. In Tennessee, state regulators have determined that BellSouth's wholesale rate should be 16% less than the carrier's retail rate Thus, if BellSouth's retail rate for local service were $12.15, a CLEC may purchase that service for a discounted price of $10.31.
> During cross-examination, [BSE] was asked to assume, for the sake of argument, that BellSouth's $12.15 rate was also the price floor for that service, as calculated in accordance with section 208(c) Under those circumstances he repeatedly maintained that BSE could legally purchase BellSouth's service at the wholesale rate and resell it for $10 31 or $10.81, substantially less than BellSouth's price floor In an effort to persuade the TRA to approve BSE's proposal, [BSE] said BSE would agree to price its services at no less than $10 31--the wholesale price it paid to BellSouth--but would not agree to abide by BellSouth's price floor of $12 15

The TRA was also unconvinced that BSE's offer regarding the price floor was sufficient to alleviate its concerns about anticompetitive conduct and found

> In an effort to lessen the anti-competitive effect of its expanded certification, BSE agreed to be bound by a price floor equal to the resale price paid to BellSouth for the purchase of its telecommunications services However, BSE failed to demonstrate whether the resale price it will pay to BellSouth will or will not include operator service costs, administrative costs, or marketing and advertising costs Absent an evidentiary demonstration of all costs to be included in the resale price paid to BST, the "price floor" promised by BSE may not be comparable to that set for incumbents under Tenn Code Ann § 65-5-208(c). Furthermore, the Authority is of the opinion that if a price floor is to act as a deterrent against price squeezing, the floor must be set in a manner that will ensure that all of the costs of providing the services are included therein. Thus, a meaningful promise to be bound to a price floor will not only include the rate paid to BellSouth by BSE, but will also include additional costs incurred by BSE in providing such services Under BSE's proposal to set the price floor at the resale rate paid to BellSouth, BSE would still be free to sell a service below the total cost that BSE must incur to provide that service

***15** On appeal, the TRA contends that the danger of a price squeeze is presented by the possibility that BSE would lower its resale price, "as long as the cost components of that price are undisclosed or are subject to manipulation," to a level that competitors of BSE and BST would be unable to match The TRA found BSE's promise to set its price floor at the resale rate it pays BST would still allow BSE to resell a service below the overall cost to BSE of providing the service. The TRA contends this situation results in an "obvious opportunity" for a price squeeze *See Town of Norwood v New England Power Co*, 202 F 3d 408, 418 (1st Cir 2000) (explaining the "traditional price squeeze")

The TRA points out that BSE has never agreed to apply the price floor as described by the TRA BSE argues that its price floor agreement must be considered in conjunction with the other safeguards it promised to comply with, which will "ensure that all of the costs of providing its services are included in its pricing."

The price floor statute only applies to incumbent providers and does not by its terms apply to CLECs In fact, in situations where an affiliate relationship with the incumbent is not present, the issue would simply not arise. Consequently, the TRA must rely upon its authority to promote competition and prevent anticompetitive practices as authority for its decision. There is no evidence in the record that in the other situations where the TRA has approved an affiliate of the incumbent provider as a CLEC that any such price floor requirement has been imposed

It is the relationship between BSE and BellSouth and BellSouth's market dominance and status as a RBOC that created the "concerns" that led the TRA to determine that anticompetitive practices might occur. It is actually the potential for BellSouth to use a subsidiary to circumvent restrictions placed on its operation by federal and state law and regulation, to the detriment of competition, which is at the core of the TRA's action The fact that it is the affiliate relationship that is the problem is exemplified in the TRA's finding that, "Counterbalancing these proposals [BSE's agreement to the listed restrictions] in the record before the TRA are BSE's numerous demonstrations of its close ties to BST. Further, as BSE's witness admitted, BSE and BST will remain affiliates BSE will be nominally independent of BST, but neither will be truly independent of BellSouth Corporation " [FN11] Although the TRA did not decide that no affiliate of BellSouth or BST could be certified as a CLEC in those areas where BST is the incumbent provider, it did not by rule or order establish minimum requirements to insure the type of independent operation it felt necessary to prevent "possibilities" for anticompetitive conduct.

> FN11 The Intervenors assert that this case is simply about whether BellSouth can be both an ILEC and a CLEC at the same time and in the same service territory "Since BSE does not propose to offer any services to Tennessee customers that BellSouth itself cannot also offer, the only apparent reason for BSE's creation is to allow BellSouth to do indirectly, through an affiliate, what it cannot do directly, i.e , to engage in otherwise prohibited pricing and marketing strategies " The intervenors assert that the BellSouth companies are attempting to avoid the effect of those statutes which prohibit BellSouth itself from obtaining a CLEC certificate and which regulate BellSouth as the incumbent provider This argument presupposes, among other things, that there is no structural and operational separation between the affiliates.

The FCC has addressed concerns similar to those raised by the TRA in the context of a Section 272 affiliate (an affiliate of a BOC which meets the structural separation requirements of 47 U.S C § 272) in its report entitled *In the Matter of Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, As Amended,* CC Docket No. 96-149, First Report and Order (rel Dec. 24, 1996) wherein it made the following findings.

> ***16** We also conclude as a matter of policy that regulations prohibiting BOC section 272 affiliates from offering local exchange service do not serve the public interest. The goal of the 1996 Act is to encourage competition and innovation in the telecommunications market We agree with the BOCs that the increased flexibility resulting from the ability to provide both interLATA and local services from the same entity serves the public interest, because such flexibility will encourage section 272 affiliates to provide innovative new services To the extent that there are concerns that the BOCs will unlawfully subsidize their affiliates or accord them preferential treatment, we reiterate that improper cost allocation and discrimination are prohibited by existing Commission rules and sections 251, 252, and 272 of the 1996 Act, and that predatory pricing is prohibited by the antitrust laws. Our affiliate transaction rules, as modified by our companion Accounting Safeguards Order, address the BOCs' ability to engage in improper cost allocation. The rules in this Order and our rules, in our First Interconnection Order and our Second

> Interconnection Order ensure that BOCs may not favor their affiliates In sum, we find no basis in the record for concluding that competition in the local market would be harmed if a section 272 affiliate offers local exchange service to the public that is similar to local exchange service offered by the BOC
>
> *Id.* at ¶ 315 (footnotes omitted)

Of course, BSE is not a Section 272 affiliate, and the structural separation requirements established in that provision are not automatically imposed upon BSE There is no impediment, however, to the TRA imposing the same safeguards as a condition to certification, by virtue of its authority under Tenn.Code Ann § 65-5-208(c) [FN12] In fact, BSE and BellSouth agreed to be bound by those structural separation requirements. The TRA could have included other requirements directly related to preventing anticompetitive practices between BSE and BellSouth Again, BSE and BellSouth agreed to additional safeguards, including the filing of various documents, accepting advertising restrictions which ensure the proper identification of the affiliate, providing cost allocation data, and setting its price floor equal to the wholesale price it pays to BST

> FN12 The Georgia Public Service Commission, in ruling on a similar application by BSE in Georgia, stated that:
> The critical issue that is raised in this proceeding stems from the affiliate relationship the Applicant has with the predominant incumbent local exchange carrier in Georgia, BellSouth Telecommunications, Inc. Testimony presented by the intervenors raises questions as to whether the service expected to be provided by the Applicant will indeed be in competition with BST Or, will the entry of the Applicant into the local exchange market simply garner for the parent corporation an even larger share of the market in Georgia and thereby thwart the movement toward telecommunications competition in the state. After finding that there was not sufficient cause to deny the application, the Commission found that certain conditions would be imposed. Those included use of the same operating system support as other CLECs, a prohibition of favoring treatment to BSE by the incumbent, and certain reporting requirements.

The TRA determined these offers were not sufficient However, it did not, by order or rule, establish the minimum requirements or safeguards it thought necessary Instead, it determined that BSE did not sufficiently allay concerns that anticompetitive practices might occur. The TRA found that approval of BSE's application "may" be inconsistent with the goal of fostering competition, that potentially abusive, collusive behavior "might" occur, and that the relationship "could be potentially" adverse to competition

Additionally, the TRA is not bound by the FCC's judgment that competition in local markets would not be harmed, considering the safeguards provided elsewhere, if Section 272 affiliates were to offer local service. The TRA is authorized to make its own determination about the effect of competition in this state However, the TRA did not make a determination that competition would be adversely affected by certification of BSE statewide. It merely found that certification "may" be contrary to promotion of competition. Apparently, any harm to competition would come only if the affiliated entities acted collusively, in an anticompetitive manner, and in violation of existing prohibitions

***17** While Tenn Code Ann § 65-5-208(c) authorizes the TRA to implement safeguards to prohibit anticompetitive conduct between an ILEC and its affiliated CLEC, we can find nothing in the statute to authorize the TRA to deny certification of a related entity simply because, by its nature, the affiliate relationship may provide the opportunity for anticompetitive practices. The legislature has prohibited anticompetitive conduct, not affiliation relationships. The TRA's responsibility in that situation is to put in place standards or requirements to prohibit and prevent the anticompetitive possibilities from becoming realities and/or to make violations easier to discover so that regulation is effective.

We conclude that the TRA's decision herein must be vacated because it is in excess of the statutory authority of the agency We remand to the TRA for consideration of BSE's application in light of the

principles set out in this opinion. Because the order which is the subject of this appeal does not establish standards, requirements, or conditions, for the certification, we do not rule upon the validity of any such requirement [FN13] Costs of this appeal are taxed to the **Tennessee Regulatory Authority**.

> FN13. For example, we decline to address the issue of whether the TRA may impose a minimum charge or price floor on BSE which insures it recoups all its costs.

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