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T.R.A. DOCKET ROOM

June 23, 2006

Ron Jones, Chairman
Tennessee Regulatory Authority
460 James Robertson Pkwy
Nashville, TN 37243-0505

Re: ***Application of Bristol Tennessee Essential Services for a Certificate of Convenience and Necessity to Provide Competing Telecommunications Services***
Docket number: 05-00251

Dear Chairman Jones:

Bristol Tennessee Essential Services ("BTES") submits this response to the letter filed June 9, 2006 by Mr. Edward Phillips on behalf of United Telephone Southeast ("UTSE"). Mr. Phillips' letter addresses an audit, now underway, of BTES' Cost Allocation Manual ("CAM").

The audit is being conducted by an independent, outside auditor, Mr. William H. Novak of WHN Consulting. As required by the Settlement Agreement,[1] Mr. Novak has filed his proposed audit procedures with the Authority for review by the agency's staff. The staff has raised no objections to those procedures. Similarly, Mr. Phillips states in his June 9 letter that UTSE "has no objection to the language of the audit scope" submitted by Mr. Novak. Letter, at 2.

Although UTSE does not object to Mr. Novak's proposed methodology, the June 9 letter appears intended to persuade the TRA staff, even before the auditor completes his work, that "BTES is unfairly allocating the cost of its fiber-optic system to its electric business unit." Id. In making that argument, the letter also appears to be trying to influence how Mr. Novak should conduct the audit and the conclusions he should draw.

While BTES believes that it is premature for the parties to make filings debating the CAM while the audit is still under way, UTSE's statements in the letter indicate a misconception of the cost allocation process.

As BTES explained in unchallenged testimony to the TRA, the additional fiber optic plant installed by BTES was purchased for the benefit and use of the electric business unit and its customers. The system will provide a number of benefits for electric customers and will also allow the company to better manage its system, identify outages more accurately and read meters

[1] BTES agreed to the CAM audit as part of a Settlement Agreement with UTSE. The Agreement was later ratified by the Authority and incorporated into the Authority's Final Order granting BTES a certificate of convenience and necessity to offer telecommunications services in Tennessee.

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remotely. For those reasons, the Board of BTES approved the addition of the new fiber-optic plant as part of the utility's electric system.

At the same time, BTES recognized that the fiber-optic network could also be used to provide high quality telephone, cable television, and Internet access services and that revenues from those services could substantially offset the costs of installing and maintaining the fiber optic system. As noted in the CAM, BTES expects to sell more than 16,000 cable, Internet, or telephone services. BTES conservatively estimates that revenue from these new services will not only cover the annual costs of operating the telephone, cable, and Internet business units but will also contribute sufficient additional revenue to pay the cost of the capital investment in the entire fiber-optic plant. Based, in part, on the anticipated contributions, both TVA and the State Comptroller approved BTES' decision to capitalize the non-electric business units with an inter-divisional loan from the electric unit.

As required by the TRA, BTES has adopted allocation procedures to reasonably assign the costs of the new system among the company's electric and non-electric business units. In accordance with the FCC's rules for separating regulated from nonregulated costs, 47 C.F.R. §64.901, and the agency's orders interpreting those rules, BTES has allocated these costs directly, where possible, and indirectly based, in part, on the numbers of customers using, or benefiting by, these services. See 47 C.F.R. §64.901(b)(4). TVA has reviewed and approved these cost allocation procedures.

UTSE, however, does not apparently believe that costs should be allocated based on relative usage but argues that costs should be apportioned according to "revenue increases and/or operating cost decreases." Id. UTSE contends, for example, that since BTES allocates approximately 56% of the jointly used plant to the utility's electric operations, BTES must demonstrate that the new system will increase electric system revenue and/or reduce electric system expenses by a total of 56%. Otherwise, according to UTSE, the outside auditor should find that the 56% allocation factor is invalid.

UTSE's argument that jointly used plant should be allocated based on revenues produced or savings generated rather than on relative usage is not consistent with the FCC's rules on cost allocation. The new fiber optic system, for example, will give BTES more control over electric usage, reduce peak demand, and help restore service after an outage. These capabilities cannot be translated directly into either "savings" or "increased revenue" for the electric business unit but they will directly benefit the company's electric customers. Likewise, the installation of the new system will generate additional revenue from subscribers to cable, telephone, and Internet access services. But that does not mean that the costs of the jointly used plant should be allocated based on how much customers are expected to pay for these non-electric services. Those decisions will be based on market conditions and have no bearing on the cost allocation process.

The FCC has recognized that outside plant investment costs jointly used by both regulated and nonregulated services may be allocated in a variety of ways, such as by estimating the number of customers who use a particular service. But no reasonable allocation method would assign jointly used plant based on how much revenue is generated, or how much savings are produced, by the various services which use the plant.

For those reasons, BTES believes that the arguments raised by UTSE are not only premature but flawed. BTES looks forward to the imminent completion of the CAM audit and further discussion with the staff on these issues.

Very truly yours,

BOULT, CUMMINGS, CONNERS & BERRY, PLC

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6/23/2006