

IN THE CHANCERY COURT
FOR HAMILTON COUNTY, TENNESSEE
AT CHATTANOOGA

COMCAST OF THE SOUTH,)
a Colorado General Partnership,)
)
Plaintiff,)
)
v.)
)
ELECTRIC POWER BOARD)
OF CHATTANOOGA,)
)
Defendant.)

Docket No. 08 0291

COMPLAINT

Plaintiff Comcast of the South, a Colorado General Partnership, ("Comcast") for its Complaint against Defendant Electric Power Board of Chattanooga ("EPB") states:

Summary

1. This case involves unique and complex questions of law and fact. EPB is attempting to enter the cable/Internet business. It plans to use electric revenues to finance capital investment that should be borne by a separate cable/Internet division. It also intends to shift to the electric utility the financial risk in terms of network investment and operating costs that should be the obligation of the cable/Internet division. By so doing, EPB is using its municipal electric utility revenues to subsidize the investment and operations of the proposed cable/Internet division in violation of the Cable

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Act, Tennessee Code Annotated Section 7-52-601 et seq. As set forth more fully and specifically below, Comcast is entitled to a declaratory judgment as to EPB's violation of the Cable Act.

Parties, Jurisdiction and Venue

2. Comcast provides cable television, high speed Internet and voice-over-internet protocol (VoIP) enabled digital voice services in Hamilton County and other surrounding counties. Comcast is a franchisee as that term is used in Tennessee Code Annotated Sections 7-59-101 et seq. operating in EPB's service area.

3. EPB was created as a division of the City of Chattanooga by private act in 1935. As a municipally owned electric plant, EPB provides electric power to all of the business and residential customers in the City of Chattanooga, most if not all of Hamilton County, and parts of five other Tennessee counties.

4. This Court has personal jurisdiction over EPB because it is headquartered and operates in Chattanooga, Tennessee. This Court has subject matter jurisdiction pursuant to Tennessee Code Annotated Section 7-52-609 and Tennessee Code Annotated Sections 29-14-101 et seq. Venue is proper in this Court pursuant to Tennessee Code Annotated Section 7-52-609 which provides: "[a] franchisee under chapter 59 of this title operating in the service area of a municipal electric division

providing services under this part may bring a civil action for injunctive or declaratory relief for a violation of this part . . .[.] Jurisdiction and venue for such action shall be in the chancery court in the county where the alleged violation is occurring or will occur.”¹

Factual Background

5. In 1999, the Tennessee General Assembly adopted the Cable Act. The Cable Act permits municipal electric plants, subject to certain conditions, to provide cable, Internet and related services within their existing service areas.

6. The Cable Act sets forth various steps that an electric plant must take to pursue a cable/Internet venture. Tennessee Code Annotated Section 7-52-602 states in pertinent part:

[t]o provide the services authorized under this part, the governing board of the municipal electric system shall comply with the following procedure:

(1) Upon the approval and at the direction of the governing board, the municipal electric system shall file a detailed business plan with the office of the comptroller of the treasury that includes a three-year cost benefit analysis and that identifies and discloses the total projected direct cost and indirect cost of and revenues to be derived from providing the proposed services. The plan shall also include a description of the quality and level of services to be provided, pro forma financial statements, a detailed financing plan, marketing plan, rate structure and any

¹ Comcast also believes that venue is proper in Davidson County on account of certain actions by EPB in Davidson County.

other information requested by the director of the division of local finance;

(2) After review of the plan, the comptroller of the treasury shall provide written analysis of the feasibility of the proposed business plan to the chief legislative body of the municipality in which the municipal electric system is located and the governing body within sixty (60) days; provided, that the calculation of the time to file the comptroller's written analysis shall not commence until the business plan is complete. Upon expiration of the sixty-day period, the governing board may proceed without the written analysis of the comptroller;

(3) If the governing board determines to proceed, it shall publish in a newspaper of general circulation within that area, a notice of its intent to proceed with the offering of additional services. The notice shall include a general description of the business plan and a summary of the governing board's findings on such plan. The notice shall also specify a date on which the governing board shall conduct a public hearing on the provision of such services;

(4) The governing board shall conduct a public hearing on the provision of such services. No sooner than fourteen (14) days after such public hearing, the governing board may consider authorizing the provision of additional services. A municipal electric system may provide additional services only after approval by a two-thirds (2/3) majority vote of the chief legislative body of the municipal electric system is located or by a public referendum held pursuant to subdivision (5)[.]

7. Municipal electric plants are largely unregulated, governmentally owned and operated monopolies. By virtue of their control of a captive electric market, municipal electric utilities have significant financial advantages, including access to low-cost capital based on their low-risk monopoly business, as well as favorable tax status.

8. The Cable Act contains various provisions intended to ensure that municipally owned utilities do not engage in behavior that will harm the structure of the competitive markets. The Cable Act requires, for example, that the municipal electric system create a separate division to provide cable/Internet services. Although the Cable Act identifies various financing methods for cable/Internet ventures (including the issuance of bonds and the making of inter-divisional loans), it expressly prohibits, at Tennessee Code Annotated Section 7-52-603, a municipal electric utility from subsidizing the operations of the cable/Internet venture: "[a] municipal electric system may not subsidize the operations of the [cable/Internet] division with revenues from its power or other utility operations." (Emphasis added). In that same section, the Cable Act further states that "[a] municipal electric system providing any of the services authorized by this part shall fully allocate any costs associated with the services provided under this part to the rates for those services."

9. The prohibition on cross-subsidization and the requirement of cost allocation promote fair competition and also protect electric rate-paying customers. Cross-subsidization and improper cost allocation have at least two negative impacts. First, on the basis of special advantages including the utility's access to low-cost capital arising from its monopoly

services, tax exemptions and potential ability to use utility personnel and other assets, the electric utility could gain an unfair competitive advantage in selling services such as cable/Internet below the real costs incurred in providing the services. This could significantly harm the competitive marketplace, resulting in negative outcomes for consumers like higher prices in the long term and less incentive to implement technological advantages. Second, electric customers, who are forced participants in a captive market, may be required to pay higher rates to support the cable/Internet division even though the electric customers may not use the cable/Internet services.

10. The provision of cable/Internet services, regardless of whether the provider is a governmental entity or a private operator, is very expensive, significantly because of the extraordinarily high capital costs in deploying a fiber-to-the-home network. The cable/Internet provider must purchase very expensive electronic equipment and must install or bury thousands of miles of cable/wire/fiber infrastructure, the transport mechanism through which the cable/Internet signals flow. The major financial risks in offering fiber-to-the-home cable/Internet services are based on the very high level of expenditures to construct the network, and to a lesser extent on operating and marketing the telecommunications services. The operational and financial cross-subsidy is first related to the

network investment and second in pledging utility revenues against potential shortfalls in the cable/Internet operating performance.

11. Upon information and belief, EPB became interested in providing cable/Internet services in 2006 or early 2007.

12. On or about August 17, 2007, EPB approved a "Business Plan for Providing Fiber to the Home" (the "Business Plan") for the proposed development of a cable/Internet network (the "Network"). A true and correct copy of the Business Plan is attached as Exhibit A.

13. The Business Plan summarizes EPB's intended course:

[t]his business plan offers a business model that defines the market opportunity, operating model and the financial requirements for the deployment of a Fiber-to-the-Home (FTTH) network to the EPB service area in Tennessee. EPB proposes to introduce competition into the broadband market by offering residential and commercial customers the most advanced next generation video services, symmetrical high speed internet access, and telephone services equivalent to those available in the world's most progressive cities. *** Specifically the project includes building a 6,900 mile fiber network that passes every customer in the area. The plan proposes a \$250 million capital investment over five years that is projected to capture 35% of the available market and mature to a \$50 million a year business operation.

See Business Plan, Executive Summary, Section 1, at p. 1.

14. The Business Plan describes EPB's financing model.

EPB states:

[t]he cost to build a state-of-the-art network is substantial. The project will require capital

expenditures of \$205 (50% Take Rate) million plus an additional \$10 million in working capital for a total financing requirement of \$215 million. The capital expenditures for the Electric System portion of the network (82%) are estimated at \$169 million. Studies are currently under way to determine the Electric System's needs. This model anticipates that bonds will be able to cover the cash needs of the FTTH network. The revenues from the FTTH services will be used to cover the debt service requirement for its portion of the network.

See Business Plan, Section 9, FTTH Financial Model, at p. 2. (Emphasis added).

15. EPB's Business Plan further states: "[t]he fiber optics network will consist of a new fiber optics distribution system passing every home and business in the service area and will be the largest single initial capital expenditure. The network will consist of transport fiber and electronics, distribution fiber and electronics and customer premise fiber drops and electronics. *** Fixed capital costs include the cost of building the fiber optic network, constructing a central office building, and installing a cable TV head-end (electronics that are required to receive and disseminate cable TV signal)." Id. at p. 4. EPB also states in the Business Plan: "[t]he total external financing requirement is assumed at \$205 Million with the FTTH supporting \$46 million." Id. at p. 5. (Emphasis added).

16. EPB also identified its cash sources and uses in the Business Plan and called for the issuance of bonds:

[b]onds will provide the initial capital financing. Cash from operations will provide the necessary capital thereafter. The bond amounts have been calculated according to a single round of funding in the first year of the plan.

The total external financing requirement is assumed at \$205 Million from a tax-exempt public bond offering. EPB is part of the City of Chattanooga. Currently it appears that there is only minimal General Obligation debt availability for the FTTH project. Revenue bonds issued in the name of Chattanooga but backed by the revenues of EPB is an option. A competitive interest rate can be achieved by utilizing EPB's strong credit rating, backing the bond with the revenues from FTTH and limited backing with other EPB revenues. ***

The revenues from FTTH services will be used to cover the debt service requirement for its portion of the network. The amount supported by the FTTH Project is approximately \$44 million. Debt service includes interest and principle.

Id. at pp. 11, 14. (Emphasis added).

17. EPB's Business Plan also contains numerous projections with respect to anticipated operating costs and gross revenues. EPB's ability to service its debt is directly dependent on the accuracy of its projections and the project's low interest rate and credit-worthiness are based on electric utility revenues, not on the new operations.

18. On or about August 17, 2007, EPB submitted a summary "EPB Fiber Optic Broadband Business Plan" (the "Summary Plan") to the Comptroller pursuant to Tennessee Code Annotated Section 7-52-602. A true and correct copy of the Summary Plan is

attached as Exhibit B. The Summary Plan, although shorter, is similar to the Business Plan.

19. The Summary Plan apportions a remarkably high eighty-two percent (82%), or \$169 million, of the overall \$203 million of capital expenditures to the electric system. See Summary Plan at p. 12. Only \$46 million, or eighteen percent (18%), of the capital expenditures are apportioned to the cable/Internet venture. Id. at p. 19. The Summary Plan also calls for EPB to charge some unspecified "access charge" to the cable/Internet division for its use of the Network. Id. at p. 12. Finally, EPB states that it may make an inter-divisional loan to the cable/Internet venture. Id. at p. 20.

20. The high level of start-up capital expenditures made EPB's development of a cable/Internet venture not viable from a financing perspective as a stand-alone proposition. Faced with that problem, EPB, as set forth in the emphasized language from the Business Plan quoted above and as set forth in the Summary Plan, adopted a bold approach that is contrary to the anti-subsidization prohibition of the Cable Act. The Business Plan on its face represents that the capital expenditures are overwhelmingly for the benefit of the electrical utility so that EPB could claim the right to use electric revenues to support the necessary bond debt obligations. It further claims that the electric system should finance the Network's construction. In

essence, EPB's cable/Internet division would be obtaining all of the infrastructure and equipment necessary to provide cable/Internet services for only a fraction of the cost that would be required of a free market competitor.

21. EPB attempts to justify its use of electric revenues and shifting of costs to the electric system, actions which effectively serve to use electric revenues to subsidize the cable/Internet venture, by claiming without proof, support or verification that the Network will allow EPB to operate a so-called "Smart Grid" and thereby generate tremendous cost savings. According to EPB, the "Smart Grid" can be used to read meters remotely, eliminate millions of dollars of electricity theft (a criminal deed not often discussed) and to perform other services of a similar nature. In contrast to the benefits and issues associated with the cable/Internet venture, which are discussed at length in the hundreds of pages contained in the Business Plan, a total of four pages are devoted to discussing the supposed electric system benefits. The Summary Plan devotes even less attention to this topic as if the avoided electronic costs are not truly fundamental to the project. In fact, even a cursory reading of EPB's Business Plan reveals that the company was committed to a capital investment of more than \$200 million for a cable/Internet operation even as the plan candidly admits that "[s]tudies are currently under way to determine the

Electric System's needs." The electric system's financial justification was not germane to the plan. See Business Plan, Section 9, FTTH Financial Model, at p. 2.

22. EPB's Business Plan describes the Network architecture. It extols the supposed virtues of its fiber-based technology and asserts that it offers "the speeds and bandwidth necessary to make high-definition video and data/voice/Video lines not only possible but practical. *** Many industry watchers believe that fiber technology will deliver universal broadband access for high-end applications and will prove to be a seamless, end-to-end technology for communications." See Business Plan, Section 6, Network Architecture, at p. 2.

23. The fiber to be used by EPB for its "Smart Grid" is the exact same fiber over which EPB's cable/Internet transmissions will flow. Notably, EPB cannot provide cable/Internet services without the fiber. As EPB recently stated publicly: "[a]nd soon, building upon the fiber network which enables the Smart Grid, we will begin offering our community the internet, video and telephone choices and options that they've told us they want."² (Emphasis added).

24. Upon information and belief, the type and amount of fiber that EPB is installing and/or intends to install is far

² This is a quote from Harold DePriest, EPB's President and Chief Executive Officer. It was published on the website located at <http://www.chattanooga.com> on April 14, 2008.

greater than that necessary to secure the electric system benefits that EPB purportedly seeks. Moreover, upon information and belief, those benefits could be obtained by far less costly means. Thus, it is reasonable to conclude that EPB's true motivation for creating the Network is to enable it to enter the cable/Internet market and its focus on the supposed electric system benefits is intended to attempt to justify its shifting of costs from the cable/Internet division to the electric system. This shifting of costs is an attempt to justify a cross-subsidy.

25. On or about August 21, 2007, the Comptroller provided a written analysis of the feasibility of the Summary Plan (the "Feasibility Report") subject to certain assumptions. Those assumptions relied upon were derived exclusively from the Summary Plan itself, as prepared and presented by EPB. The Feasibility Report is attached as Exhibit C.

26. On or about September 5, 2007, EPB conducted a public hearing pursuant to Tennessee Code Annotated Section 7-52-602.

27. On or about September 21, 2007, EPB held a meeting and approved the Plan for the provision of the services contemplated therein.

28. The Tennessee Cable Telecommunications Association (the "TCTA") is a trade organization whose members are primarily owners and operators of franchised cable television systems

throughout the state of Tennessee. Comcast is a member of the TCTA. On September 21, 2007, TCTA filed a Complaint in Davidson County Chancery Court asserting that EPB's stated course of conduct ran afoul of the Cable Act's prohibition on cross-subsidization. TCTA sought a declaration as to the illegality of EPB's conduct and an order prohibiting EPB from proceeding with its cable/Internet venture as described in the Business Plan and Summary Plan.

29. In February of this year, EPB submitted a proposed financing change to the Comptroller (the "Revised Summary Plan"). A copy of the Revised Summary Plan is attached as Exhibit D. The change modified the financing of the cable/Internet portion of the venture. The original proposal called for apportioning \$46 million of expenditures to the cable/Internet division. Approximately, \$35.6 million was to be obtained through revenue bonds backed by the cable/Internet division's revenues and \$10.4 Million dollar were to be obtained through an inter-divisional loan from EPB. The new proposal increased the overall potential commitment for the cable/Internet division by nearly \$15 million to \$60 million. It also called for the entire amount to be funded by means of an inter-divisional loan from EPB to the cable/Internet division and provided for the loan to be secured, in the event the cable/Internet division failed to service the debt, by

incremental in-lieu of tax payments to the city and county (and the city and county have approved this proposal). Private competitors, like Comcast, are not entitled to municipal/county tax breaks to offset the possible risk of financial failure.

30. A document submitted with the Revised Summary Plan, specifically a letter dated February 15, 2008 from the Tennessee Valley Authority to EPB discusses more specifically EPB's method of allocating costs for Network usage. See Exhibit D. The allocations appears to ensure that the electric system, regardless of what happens with respect to the cable/Internet division will inevitably bear a significant portion of the cost of the Network (and, according to EPB's projections, the majority of the cost). The EPB-proposed allocation method is based on the number of customers which means the total of electric and other telecommunications subscribers, so that the electric system will necessarily absorb more of the Network and operating costs during the early years of the cable/Internet venture—a time when a free market competitor would be most vulnerable.

31. EPB's allocation plan is seriously flawed and is not based on financial realities. EPB, in Exhibit A to the Revised Summary Plan (to Exhibit D to the Complaint), Cost Allocation Overview cites the Federal Communications Commission's ("FCC") cost allocation model in a BellSouth case, noting that the FCC

permitted BellSouth to assign costs using the total number of subscribers for cable combined with the total subscribers for telephone services. EPB contends, therefore, that it should use the number of electric customers that use the network plus the number of other projected customers for video, data and telephony in arriving at an allocation of costs.

32. EPB's proposed result is that eighty-two percent (82%) of the capital expenditures are borne by the electric utility. However, the reality is that the FCC's allocation related to a single network (one access line to the home) that was necessary to generate differentiated video and telephone services. In this case, EPB already has an electric network and is proposing to allocate eighty-two percent (82%) of an expensive, incremental broadband network. The effect is to assign \$169 million or nearly \$1,000 per rate-paying electric customer for a network that purportedly will save an unverified amount in electric system costs.

33. There are key differences in this allocation compared with the FCC-approved approach. The BellSouth network in question was fundamental to generating telephone and cable services, each of which had approximately comparable revenues and cash flows. In this case, the EPB only proposes to avoid certain unverified electric costs, while it expects to generate cable/Internet revenues and cash flows. The "services" and cash

flows based on the FTTH network for electric customers and for cable/Internet customers are not remotely comparable, as the savings for the electric customers are expected to be dwarfed by the telecommunications business opportunity as presented by EPB's Business Plan.

34. A financially sound allocation approach would necessarily attempt to justify the electric utility's investment by calculating new electric revenues and/or actual electric costs avoided. Using the new benefits to the electric utility, a financial analysis could be derived as to what percentage of the new investment is applicable to the electric operations. In short, the per-user allocation is crude and is not financially sound. While EPB does write about potential savings (in its Business Plan at Section 10), nowhere is there an analysis of verifiable costs at EPB or any other utility. Further, there is no financial analysis of reasonable alternatives such as wireless networks, leased capacity on the networks of telephone or cable providers, or quantification of other approaches to resolve problems such as theft detection (forty-eight percent (48%) of the purported annual savings).

35. On February 25, 2008, the Comptroller responded to EPB's Revised Summary Plan. The Comptroller's February 25, 2008 response is attached as Exhibit E.

36. EPB has not had a subsequent public hearing with respect to the Revised Summary Plan.

37. Throughout late 2007 and into 2008, although EPB did not have its bond financing in place, EPB began to move forward with creating its Network. It has been acquiring necessary materials and it has begun attaching its fiber to utility poles.

38. On April 14, 2008, the Davidson County Chancery Court dismissed the TCTA lawsuit, primarily based on the conclusion that venue was not proper in Nashville, that the Court did not have jurisdiction and that TCTA did not have standing. The case was dismissed before any discovery was taken. TCTA believes that the Court's dismissal was not appropriate. It intends to continue pursuing the Davidson County case.

39. EPB may modify its electric system. However, it cannot lawfully use electric system revenues to obtain financing for and to service the debt relating to Network associated expenses that should be borne independently by the cable/Internet division. EPB's method of allocating capital expenditure and operating costs is also grossly improper. It is not consistent with sound financial analysis and it constitutes impermissible cross-subsidization.

40. The cable/Internet division should bear the financial risk for capital expenditures and operating costs that are necessary for a Network built primarily for a set of services

that, according to the Business Plan will serve only thirty-five percent (35%) of the population. The electric customers should not be required to pledge their rates in the form of EPB's revenues to finance a costly and higher-risk enterprise. EPB's method of financing the Network and its method of servicing the Network debt constitute prohibited cross-subsidization. EPB's improper allocation of capital expenditures and operating costs also constitutes prohibited cross-subsidization.

41. The Cable Act permits municipal electric plants to make inter-divisional loans to their cable/Internet divisions. EPB proposes to make a very large loan to its cable/Internet division. The cable/Internet division's ability to service the loan is dependent on the new enterprise's ability to meet certain market share and revenue projections. On information and belief, EPB's projections are based on unrealistic contentions regarding market penetration (projections that are higher, upon information and belief, than actual results obtained in any other competitively similar circumstance). To the extent EPB's projections are not met, it will be unable to service its debt commitment. EPB's current pledge is a financial commitment that raises the risk for its utility customers. Thus, EPB's loan is at worst ill-considered and is at least a financial pledge to absorb higher financial risk. If not repaid as promised, it is not a loan but rather a gift.

This gift is, effectively, a subsidy prohibited by the Cable Act.

42. EPB hails its cable/Internet venture as bringing competition to the market. If EPB is permitted to use electric revenues to cross-subsidize its cable/Internet venture, the result will be a violation of competitive marketplace principles and an unfair advantage to a publicly funded entity.

Declaratory Judgment

43. Comcast incorporates herein by reference those allegations contained in Paragraphs 1 through 42.

44. A justiciable case or controversy exists. This controversy presents a real question, not a theoretical one, and legally protectable interests of the parties are at stake.

45. As set forth above, Comcast contends that EPB's stated and current course of conduct involves illegal cross-subsidization prohibited by the Cable Act. EPB contends that it has not violated the Cable Act.

46. Comcast is entitled to a declaratory judgment pursuant to Tennessee Code Annotated Sections 29-14-101 et seq and 7-52-609.

WHEREFORE, PREMISES CONSIDERED, Comcast asks that the Court do the following:

1. Expedite discovery and the trial of this matter pursuant to Tennessee Code Annotated Section 7-52-609;

2. Enter a declaratory judgment that:

A. EPB's method of using electric revenues to finance the Network and to service debt related to the Network constitutes a cross-subsidy prohibited under the Cable Act;

B. EPB's stated goal of upgrading its electric system is only a make-weight justification for shifting expenses that should be borne by its cable/Internet division to the electric system. The cable/Internet division should bear all or substantially all of the capital expenditures and operating costs for the Network. EPB's allocation of the vast bulk of the capital expenditures and operating costs associated with the Network to the electric system rather than to the cable/Internet division is improper and constitutes a cross-subsidy prohibited under the Cable Act;

C. EPB cannot make inter-divisional loans to its cable/Internet division without a reasonable expectation of those loans being repaid. Because EPB's projections are unrealistic, EPB's initial inter-divisional loan does not have a reasonable expectation of being repaid and EPB shall not be permitted to make any subsequent loans to the cable/Internet division if one or more earlier loans have not been paid;

3. Prohibits EPB from implementing or moving forward with the Business Plan, the Summary Plan or the Revised Summary Plan unless and until all cross-subsidization issues are addressed and corrected;

4. Award injunctive relief to the extent that Comcast shows itself entitled to such relief; and

5. Award such other further, general relief to which Comcast shows itself to be entitled.

Respectfully submitted,

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