



**STATE OF TENNESSEE  
COMPTROLLER OF THE TREASURY  
OFFICE OF STATE AND LOCAL FINANCE  
SUITE 1600 JAMES K. POLK STATE OFFICE BUILDING  
505 DEADERICK STREET  
NASHVILLE, TENNESSEE 37243-0274  
PHONE (615) 401-7872  
FAX (615) 741-5986**

May 17, 2017

The Honorable Connie Ball, Mayor  
and Honorable Board of Aldermen  
City of Newport  
P.O. Box 370  
Newport, TN 37822

Board of Directors  
Newport Utilities  
170 Cope Blvd.  
Newport, TN 37821

Dear Mayor Ball, Members of the Board, and Members of the Newport Utilities Board:

Our Office received a detailed business plan (the "Plan") for the Newport Utilities (the "System") to provide internet services. The System submitted the Plan pursuant to T.C.A. § 7-52-602, which states that the Office of the Comptroller "shall provide a written analysis of the feasibility of the proposed business plan."

We have not attempted to compare the information included in the Plan to industry standards, nor are we aware of any such industry standards for governmental entities providing these types of services. Our feasibility analysis is based on a limited review of the Plan submitted, and our expectation that the municipal electric system reviewed the Plan before submitting it to us. During our review process, we requested additional information we felt would be helpful in reviewing the Plan.

Based on the information in the Plan, including the additional requested information, we could not determine if the proposed Plan appears feasible. The rate of available residential and business customers in the System's operational area that will purchase the proposed broadband services (the "uptake rate") is projected to be 45% by the year 2021. The uptake rate is the key assumption for the projections that support the financial feasibility of the proposed broadband division. The Plan's uptake rate assumption of 45% is based largely upon the ability to attract current subscribers from other providers; however, the Plan does not address the impact of market competition on pricing. The Plan did not provide adequate assumptions, or a methodology, to support a 45% uptake rate given the number of existing service providers in the service area. Based upon the market survey results, the Plan included projections that 22% of residential homes and 12.7% of businesses do not currently subscribe to internet services, either because it is not available or too expensive. The remaining 78% residential and 87.3% business customers currently have service providers. Because the Plan did not consider the impact of market competition to the population of customers that currently have service, we could not conclude the reasonableness of the uptake rate and therefore could not determine if the Plan is feasible.

Our analysis is based upon the following assertions as presented in the Plan, including the additional information requested, submitted to this Office:

1. The project is based on the System deploying a Smart Grid network infrastructure for its electric operations. This new infrastructure will allow the System to offer high-speed internet service with the additional bandwidth available on its fiber optic lines.
2. The fiber-optic Smart Grid network will create a Fiber-to-the-Meter communication system for the System's electric power distribution network that will allow it to take advantage of future advances in Automated Metering Infrastructure (AMI), internet-based applications that control consumer appliances, and improve electric system operations by enhancing communications to critical components such as capacitor banks, re-closers, and AMI routers. This expansion project will be completed in phases, with the initial phase involving the construction of fiber distribution lines within the commercial sectors of the System's service area. The System's estimated cost for this initial fiber expansion is \$21.9 million over a six-year period.
3. The need for a communication system to provide metering and control for the System has created an opportunity to provide internet service by leasing bandwidth on its fiber optic smart grid. A separate Broadband division will provide internet service by leasing bandwidth from the System's fiber optic network.
4. To fund working capital for the broadband division during the start-up phase the electric division of Newport Utilities will establish a \$3,500,000 inter-division loan to the broadband division, funded from cash reserves of the electric division. The loan will be structured as a line of credit with a 4.5% interest rate.
5. The System intends to provide internet service using the Morristown Utilities Commission as its wholesale provider for internet services and as a third party provider for Voice over Internet Protocol (VoIP) telephone services. The System provided a letter from legal counsel for the City of Morristown, dated May 4, 2017, regarding the services to be provided. The System should consult with its legal counsel to ensure they comply with all aspects of state statutes.
6. The System's Broadband Division will offer the following services at the listed pricing:

Residential	Average Retail Pricing Assumptions (ARPU)
Internet Only - Silver 50M x 50M	\$ 39
Internet Only - Platinum 250M x 250M	\$ 59
Internet Only - Gold 1G	\$ 79
Double Play - VoIP and Silver internet	\$ 74
Double Play - VoIP and Platinum Internet	\$ 94
Double Play - VoIP and Gold Internet	\$ 114
Triple Play - VoIP-Video-Silver Internet	\$ 120
Triple Play - VoIP-Video-Platinum Internet	\$ 140
Triple Play - VoIP-Video-Gold Internet	\$ 160
Business Internet	Average Retail Pricing Assumptions (ARPU)
Internet - 50M x 50M	\$ 49
Internet 100M x 100M	\$ 79
Internet 500 M x 500M	\$ 149
Business VOIP Average (3 lines per sub)	\$ 135

\*\* Business plan includes a 2% annual increase in ARPU.

Symmetrical Internet service will be available at all service levels. Symmetrical service means that the download (receiving) and upload (sending) speeds are the same, as compared to cable internet service which typically has significantly slower upload speeds.

7. The Plan states the customers of the System are the target market for the new broadband division. We could not determine the reasonableness of the projected uptake rate of 45% of the System's current electric customers. The Plan's uptake rate assumption of 45% is based largely upon the ability to attract current subscribers from other providers; however, the Plan does not address the impact of market competition on pricing. The uptake rate is the key assumption for the projections that support the financial feasibility of the proposed broadband division.
8. Using the 30% uptake pro forma schedules provided in the Plan, the broadband division estimates losses in the first three years (fiscal years 2017-2019). The cost of leasing the fiber optic network infrastructure is included as an operating expense. It is projected that year four will be the first year that the broadband division will generate income in the amount of \$379,637. Net income remains positive for the remainder of the ten-year pro forma schedule. Cash flows are projected to be positive for the entirety of the ten-year forecast period, due to the operational borrowing in the first three years from the electric division.
9. The System's attorney submitted a letter that provided assurance that the services in the proposed Plan are limited to providing internet services.

The Tennessee General Assembly has enacted legislation that authorizes local governments to provide these services through their municipal electric systems. This legislation also places numerous responsibilities on local governments who determine to provide such services, including the following:

- A. A separate accounting and record-keeping system must be maintained for the operation of the municipal electric system's internet services program. All costs, both direct and indirect, incurred in the operation of the program must be allocated to the rates charged for the services provided.
- B. A municipal electric system cannot subsidize the activities of the internet services program by using revenues of its power or other utility operations. The only authority to use electric system funds is through the lending of funds, on a temporary basis, by an electric system. An electric system must charge interest to the internet services program for any loans at a rate equal to the highest rate then earned by the electric system on its invested plant funds.
- C. An internet services program must adhere to the same terms/conditions provided in existing power pole attachment agreements, including cost allocations for rates, insurance and other expenses normally associated with similar programs operated by private providers. The rate charged to the internet services program for pole attachments must be equal to the rate charged other franchise holders providing similar services.
- D. An electric system must provide the same response times and service quality to requests made by a private provider of similar services as it provides to the electric system's internet services program.
- E. An electric system, with respect to any internet services provided, must make tax equivalent payments as required by T.C.A. § 7-52-606; however, the tax equivalent payment to be made by the electric system may not exceed the amount that would otherwise be due if it were a private provider of internet services paying ad valorem taxes.

- F. An electric system, with respect to any internet services provided, is subject to make payments to the appropriate units of government for amounts in lieu of the following taxes: excise and franchise taxes authorized by Tennessee Code Annotated, Title 67, Chapter 4, Parts 20 and 21; sales taxes authorized by Tennessee Code Annotated, Title 67, Part 6; and local privilege taxes authorized by Tennessee Code Annotated, Title 67, Chapter 4, Part 7.

The Legislature has authorized local governments to provide these services that have historically been provided by the private sector. The Legislature has also made it clear that any costs attributable to these programs must be allocated to the rates charged for services rendered, and that none of these costs are to be subsidized by electric system revenues. This requires a significant degree of recordkeeping to ensure that all expenses are properly allocated and reported. The accounting staff of the System should be familiar with these requirements and will be responsible for maintaining these records.

The legislation stipulates that the fiscal operations of the internet services program must be included in the annual financial report of an electric system as a segment of the electric enterprise fund, and must be subject to a financial and compliance audit prepared in accordance with generally accepted governmental auditing standards. The officials of a municipal electric system should be familiar with the requirements that have been previously applied to their other utility system operations. The Comptroller of the Treasury, through the Division of Local Government Audit, shall be responsible for determining adherence to such audit and reporting requirements. Representatives of the Division of Local Government Audit may be contacting you and your independent auditor concerning these audits.

This constitutes the report of this Office pursuant to the requirements of T.C.A 7-52-602. If the Newport Utilities Board determines to proceed with the Plan, it must publish a notice as required by law in a newspaper of general circulation in the area to be served which specifies the date on which the Board will conduct a public hearing concerning this project. In addition, in order to proceed with the Plan, and subsequent to the public hearing, approval must be obtained by a two-thirds (2/3) majority vote of the Board of Mayor and Aldermen or by public referendum. If actual circumstances such as the scope of the project, bond interest rates, cost of construction, or amount of bonds issued require the Newport Utilities Board to approve revisions to this business Plan for compliance with T.C.A §7-56-602(a), the Plan should be resubmitted to our Office for a revised feasibility determination.

Sincerely,



Sandra Thompson

Director of the Office of State and Local Finance

cc: Mr. Jim Arnette, Director, Division of Local Government Audit  
Mr. Glenn Ray, General Manger, Newport Utilities

Enclosures: Letter from Miller & Martin PLLC  
Letter from Bacon Jessee Perkins, LLP



MARK W. SMITH  
 Direct Dial 423-785-8357  
 Direct Fax 423-321-1527  
 Mark.Smith@millermartin.com

April 25, 2017

Mr. Ronald H. Queen  
 Manager of Local Finance  
 Tennessee Office of State and Local Finance  
 1600 James K. Polk Building  
 505 Deaderick Street  
 Nashville, Tennessee 37243-0273

RE: Newport Utilities

Dear Mr. Queen:

You have asked that we address the status of the services provided in the broadband business plan of Newport Utilities (or "NU") under Part 6 of Chapter 52 of Title 7 of the Tennessee Code as a matter of state law.

As we understand it, NU's primary offerings will be video services and broadband Internet service. NU will not offer telephone and telecommunications services to its customers. Instead, NU will permit a third-party voice-over-internet protocol provider ("VoIP") to make available VoIP phone service to residential and commercial customers utilizing its broadband Internet network. The third party VoIP provider will be responsible for handling the voice traffic and for interconnecting its VoIP customers with the traditional telephone network. NU will simply provide the broadband Internet connectivity over which the VoIP provider will provide its VoIP phone service. Through a wholesale arrangement with this provider, NU will receive compensation for this third-party provider's use of NU's broadband Internet network. For commercial customers that desire this service, NU will also offer services to create a virtual private network over its broadband Internet network that will enable communications between two buildings. In each case, NU's services will be limited to providing broadband Internet services. In other words, NU is only providing the broadband Internet service that enables the VoIP service to operate. NU will not directly provide VoIP service to end use customers.

We further understand that the proposed business plan does not include projected revenue for any traditional telecommunications services.

Title 7, Chapter 52, Part 6 specifically authorizes entities like NU to provide "Internet service." At this point in the ever-evolving state of broadband law, regulatory classification is an on-going topic of considerable debate. For example, there is a recent FCC decision<sup>1</sup> involving

<sup>1</sup> By Order dated March 12, 2015, the Federal Communications Commission ("FCC") reclassified broadband Internet access service as a "telecommunications service" as a matter of federal law. *See In the Matter of Protecting and Promoting the Open Internet*, GN Docket No. 13-28, Report and Order on Remand, Declaratory Ruling, and Order. In June of 2016, the D.C. Circuit Court of Appeals upheld that Order, *United States Telecom Association*,

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 CHATTANOOGA  
 NASHVILLE

the appropriate regulatory classification of broadband Internet access services as a matter of federal law that could, by implication, ultimately impact interpretations and applications of State law.<sup>2</sup> At this point, however, there is no reported decision in Tennessee addressing the question of whether this federal regulatory classification of broadband Internet access service impacts the interpretation and application of the Tennessee statutes authorizing broadband Internet and video services (Title 7, Chapter 52, Part 6) and the statutes authorizing telecommunications services (Title 7, Chapter 52, Part 4). Additionally, recent press reports suggest that the new Chairman of the FCC may seek to reverse the recent FCC regulatory determination, which could result in yet another change in the federal regulatory classification.<sup>3</sup>

Unless and until the federal regulatory classification is resolved and unless and until a court Tennessee court holds that municipal electric systems providing Internet services are not required to follow the approval process set forth in Title 7, Chapter 52, Part 6, we believe that the more prudent approach for ensuring that NU has all the necessary authorization to provide broadband services is to continue to follow the business review process set forth in Title 7, Chapter 52, Part 6. This follows the plain language in Title 7, Chapter 52, Part 6 concerning authorization to provide Internet services.

Even if a Tennessee court were to extend this federal regulatory interpretation to the question of state law authorization, and if Internet services provided by NU were determined to be telecommunications services as a matter of state law, then NU would be required to evaluate its obligations under Part 4, Chapter 52, Title 7 of the Tennessee Code with respect to those services. NU is separately authorized to provide telecommunications services under Part 4, and so we do not expect that such a regulatory development would materially impact NU's overall broadband business. We believe that the primary impact of this would be to require separate accounting for any "telecommunications" services and, if applicable, compliance with the approval process set forth in Tennessee Code Annotated § 7-52-402 relative to any interdivision loan that may be required for telecommunications operations.

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*et al. v. Federal Communications Commission and United States of America*, Case No. 15-1063 (DC Cir., June 14, 2016).

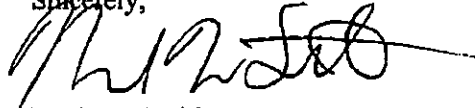
<sup>2</sup> On its face, Title 7, Chapter 52, Part 6 authorizes various broadband services, including "Internet services." See *Tenn. Code Ann. §7-52-601*. That same statute recognizes the separate authorization for "telecommunications" services that the General Assembly has provided under Title 7, Chapter 52, Part 4. Together, these statutes provide full authorization to NU provide the broadband services set forth in its business plan, irrespective of whether the FCC's current federal regulatory determination were to be applied to state law or not.

<sup>3</sup> For example, see <https://www.nytimes.com/2017/02/05/technology/trumps-fcc-quickly-targets-net-neutrality-rules.html> (visited April 24, 2017) (addressing the plans of FCC Chairman Pai to explore ways to reverse the FCC's recent regulatory classification of broadband Internet access services).

Mr. Ronald H. Queen  
April 25, 2017  
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I hope that this is responsive to your request. If you have questions or need further information, please do not hesitate to contact us. In the meantime, this letter is solely for the purpose of responding to your request for additional information and may not be relied upon or referenced for other purposes.

Sincerely,

A handwritten signature in black ink, appearing to read 'Mark W. Smith', with a long horizontal flourish extending to the right.

Mark W. Smith

MWS:cjb

**BJP** **BACON JESSEE PERKINS**  
**CARROLL & ANDERSON, LLP**

ATTORNEYS SINCE 1950

RICHARD C. JESSEE  
(OF COUNSEL)  
LAUREN A. CARROLL  
W EVAN ANDERSON

GEORGIAN COURT | 1135 WEST 3RD NORTH STREET  
MORRISTOWN, TN 37814-3891  
PHONE: 423-586-5291  
FAX: 423-581-6883  
www.bjplaw.org

HERBERT M. BACON  
(RETIRED)  
RONALD L. PERKINS  
(1944-2016)

May 4, 2017

Mr. Ronald H. Queen  
Manager of Local Finance  
Tennessee Office of State and Local Finance  
1600 James K. Polk Building  
505 Deaderick Street  
Nashville, TN 37243-0273

**RE: Morristown Utilities Commission and Newport Utilities**

Dear Mr. Queen,

This letter follows our April 26, 2017 letter and addresses additional questions related to Internet service under our Interlocal Agreement between Morristown Utilities Commission (MUC) and Newport Utilities. In the anticipated contractual agreements between both entities, MUC will enter a service and support contract to allow Newport Utilities to share services and use equipment in our footprint. The MUC equipment will be located within our footprint and MUC employees will not provide Internet related services from outside our footprint. MUC will contract directly with Newport and MUC will not have any business relationships with customers of Newport Utilities. MUC and Newport Utilities will not enter a joint venture arrangement or partnership to provide Internet services together, and the arrangement will simply be an interlocal infrastructure sharing and service agreement between the two parties.

As discussed in the April 26, 2017 letter, MUC may provide certain telecommunications services within the Newport Utilities footprint as authorized under state law.

Please feel free to contact our office if you have any further questions. Thank you.

Sincerely,



Richard C. Jessee  
Lauren A. Carroll