

PROJECT NO. 47669

RULEMAKING TO ADD 16 TEX.	§	PUBLIC UTILITY COMMISSION
ADMIN. CODE 26.407 SMALL AND	§	
RURAL INCUMBENT LOCAL	§	OF TEXAS
EXCHANGE COMPANY UNIVERSAL	§	
SERVICE PLAN (SRILEC USP)	§	
SUPPORT ADJUSTMENTS PURSUANT	§	
TO S.B. 586	§	

**PROPOSAL FOR PUBLICATION OF NEW §26.407
AS APPROVED AT THE MAY 25, 2018 OPEN MEETING**

The Public Utility Commission of Texas (commission) proposes new §26.407, relating to Small and Rural Incumbent Local Exchange Company Universal Service Plan Support Adjustments. The addition of §26.407 reflects the development and implementation of a mechanism to determine the annualized Small and Rural Incumbent Local Exchange Company Universal Service Plan (SRILEC USP) support for certain small incumbent local exchange companies (small ILEC). The proposed rule establishes criteria by which a small ILEC may request that the commission determine the amount of SRILEC USP support it receives, so that the support, combined with regulated revenues, provides the small ILEC an opportunity to earn a reasonable rate of return under this rule, as required by Senate Bill 586, 85th Legislative Session (Regular Session).

Liz Kayser, Director, Retail Markets and Licensing, has determined that for each of year of the first five-year period the new rule will be in effect, there will be no fiscal implications for state and local government as a result of enforcing or administering the amendments.

Ms. Kayser has determined that for each year of the first five years the new section will be in effect, there should be no effect on a local economy, and therefore no local employment impact statement is required under the Administrative Procedure Act (APA), Texas Government Code §2001.022.

Ms. Kayser has determined that for each year of the first five years the new section will be in effect, the anticipated public benefits will be the opportunity for certain small ILECs to be able to earn a reasonable rate of return, which will allow continued provision of local exchange service to customers in rural areas of the state. There will be no adverse economic effect on rural communities, small businesses or micro-businesses as a result of enforcing the amendments. Therefore, no regulatory flexibility analysis is required. There is no anticipated economic cost to companies that are required to comply with the new rule as proposed.

Pursuant to Government Code §2001.0221, the agency provides the following Governmental Growth Impact Statement for the proposed amendment. The agency has determined the following: (1) the proposed rule will not create or eliminate a government program; (2) implementation of the proposed rule will not require the creation of new employee positions or the elimination of existing employee positions; (3) implementation of the proposed rule will not require an increase or decrease in future legislative appropriations to the agency; (4) the proposed rule will not require an increase or decrease in fees paid to the agency; (5) the proposed rule will create a new regulation; (6) the proposed rule will expand, limit, or repeal an existing regulation; (7) the proposed rule will not increase the number of individuals subject to the proposed rule's applicability; and (8) the proposed rule will not positively or adversely affect this state's economy.

The commission staff will conduct a public hearing on this rulemaking, if requested, as required by the APA, Texas Government Code §2001.029, at the commission's offices located in the William B. Travis Building, 1701 North Congress Avenue, Austin, Texas 78701. The request for a public hearing must be received no later than 30 days after publication.

Initial comments on the new section should be submitted to the Filing Clerk, Public Utility Commission of Texas, 1701 North Congress Avenue, P.O. Box 13326, Austin, Texas 78711-3326, not later than Monday, July 9, 2018. Reply comments may be submitted not later than Friday, July 20, 2018. Sixteen copies of initial comments and reply comments are required to be filed according to 16 Texas Administrative Code (TAC) §22.71(c). Comments must be organized in a manner consistent with the organization of the amended rule. All comments must refer to Project Number 47669.

This new section is proposed under the Public Utility Regulatory Act (PURA), Texas Utilities Code Annotated §14.002 (West 2007 and Supp. 2017), which provides the commission with the authority to make and enforce rules reasonably required in the exercise of its powers and jurisdiction; §56.032, which provides the commission with the authority to revise a small ILEC's monthly support to be made available from the SRILEC USP; and §14.001, which provides the commission with the general power to regulate and supervise the business of each public utility within its jurisdiction and to do anything specifically designated or implied by the PURA that is necessary and convenient to the exercise of that power and jurisdiction.

Cross reference to statute: PURA §§14.001, 14.002, and 56.032.

§26.407. Small and Rural Incumbent Local Exchange Company Universal Service Plan Support (SRILEC USP) Adjustments.

- (a) **Purpose.** This section establishes criteria for a small incumbent local exchange company (small ILEC) to request adjustments to the monthly support the company receives in accordance with §26.404 of this title (relating to the Small and Rural Incumbent Local Exchange Company Universal Service Plan (SRILEC USP)).
- (b) **Application.**
- (1) **Small ILECs.** This section applies to a small ILEC that has been designated as an eligible telecommunications provider (ETP) by the commission in accordance with §26.417 of this title (relating to Designation as Eligible Telecommunications Providers to Receive Texas Universal Service Funds (TUSF)).
 - (2) **Other ETPs providing service in small or rural ILEC study areas.** This section applies to a telecommunications provider other than a small ILEC that provides service in small ILEC study areas that have been designated as an ETP by the commission in accordance with §26.417 of this title.
- (c) **Definitions.** The following words and terms, when used in this section, will have the following meaning, unless the context clearly indicates otherwise:
- (1) **Eligible telecommunications provider (ETP)** -- A telecommunications provider designated by the commission in accordance with §26.417 of this title.
 - (2) **Federal Communications Commission (FCC) Rate of Return** -- The FCC's most recently prescribed rate of return as of the date of any determination, review,

or adjustment under this section, to be no greater than 9.75 percent prior to July 1, 2021. If the FCC no longer prescribes such a rate of return, commission staff will initiate proceedings as necessary for the commission to determine or modify the FCC rate of return to be used for purposes of this section.

- (3) **Reasonable Rate of Return** -- An intrastate rate of return within two percentage points above or three percentage points below the FCC rate of return.
 - (4) **Small incumbent local exchange company (small ILEC)** -- For purposes of this section, a small ILEC is a small provider as defined by PURA §56.032(a)(2).
- (d) **Notification to the commission that a small ILEC seeks to participate in this section.** A small ILEC that is not an electing company under Chapters 58 or 59 may file a written notice to the commission to participate in this section to have the commission determine the amount of SRILEC USP support it receives, so that such support, combined with regulated revenues, provides the small ILEC an opportunity to earn a reasonable rate of return if the reported rate of return of such small ILEC is based on expenses that it believes are reasonable and necessary. When adjusting monthly support, the commission will consider, among other things described in this section, the adequacy of basic rates to support universal service. A small ILEC that submits a written notice to participate in this section will continue to receive the same level of SRILEC USP support it was receiving on the date of the written notice until the commission makes a determination or adjustment under this section.

(e) **Annual report of a requesting small ILEC.**

- (1) A small ILEC that submits a written notice under subsection (d) of this section must file an annual report each year with the commission, using commission-prescribed forms that are available on the commission's website. The initial annual report for a small ILEC that files a written notice under subsection (d) of this section must be filed within two months after the effective date of this section. Subsequent annual reports must be filed no later than May 15th of each year. All annual reports must be related to the most recent calendar year prior to the filing of the annual report.
- (2) The annual report filed by a small ILEC under this subsection must include information on the following:
 - (A) Summary of revenues and expenses;
 - (B) Detail for all revenue, expense, and capital accounts;
 - (C) Invested capital;
 - (D) Intrastate federal income taxes calculated at the applicable tax rate;
 - (E) Network access service revenue;
 - (F) Weighted average cost of capital;
 - (G) Historical financial statistics;
 - (H) Proposed company adjustments;
 - (I) The name, job title, and total annual compensation of each officer, director, and, for investor-owned companies, owners and former owners (including each general manager and any other highly compensated employee that may not be designated as an officer of the company), and the name and

compensation of each family member of officers, directors, owners, and former owners employed by the small ILEC;

(J) The amount and nature of each affiliate transaction, including transactions with family members of officers, directors, and, for an investor-owned company, owners and former owners;

(K) All detail and supporting documentation necessary to support each of the items above; and

(L) An authorized official's signature.

(3) The small ILEC must also provide its full and complete cost allocation manual.

(f) **Commission Staff's review of annual reports.** Annual reports submitted under this section will be reviewed by commission staff to determine whether a small ILEC's support, when combined with regulated revenues, provide the small ILEC an opportunity to earn a reasonable rate of return and whether the reported rate of return of the small ILEC is based on expenses that the commission staff determines are reasonable and necessary.

(1) **Timeline for review of the annual reports.**

(A) During the review of an annual report, commission staff may submit requests for information to the small ILEC. Responses to such requests for information will be provided to the commission staff within ten days after receipt of the request by the small ILEC. If a small ILEC fails to timely provide information to commission staff, the small ILEC will be considered to be a Category 3 provider.

(B) Within 90 days after an annual report has been filed, commission staff will complete its review of the annual report and file a memorandum for the commission's consideration regarding a final recommendation on the reported or commission-staff adjusted rate of return.

(2) **Commission staff's review of an annual report.**

(A) Commission staff will review and may make adjustments to information contained in the small ILEC's annual report, such as:

- (i) expenses that are not reasonable or necessary;
- (ii) expenses listed under §26.201(c)(2) of this title (relating to Cost of Service);
- (iii) expenses that are not in compliance with FCC rules;
- (iv) inappropriate affiliate transactions;
- (v) inappropriate cost allocations;
- (vi) inappropriate allocation of federal universal service support; and
- (vii) any other adjustments that commission staff may find appropriate.

(B) Commission staff will recalculate the small ILEC's reported rate of return and provide an adjusted rate of return if any adjustments were made in paragraph (2)(A) of this subsection.

(3) **Separation of small ILECs into rate of return categories.** Upon completion of commission staff's review of a small ILEC's annual report, commission staff will determine the appropriate category for the small ILEC within the following three categories based on the small ILEC's reported or commission-staff adjusted rate of return:

- (A) Category 1. A rate of return of more than three percentage points below the FCC rate of return;
 - (B) Category 2. A rate of return within two percentage points above or three percentage points below the FCC rate of return; and
 - (C) Category 3. A rate of return of more than two percentage points above the FCC rate of return.
- (4) Commission staff will file a memorandum for the commission's consideration of the categorization of each small ILEC in accordance with paragraph (1)(B) of this section.
- (g) **Treatment of small ILECs based on rate of return categories.** Each category will be processed as set forth below.
- (1) **Category 1** – A small ILEC that has a reported or commission-staff adjusted rate of return in Category 1 may file an application for an adjustment to have its annual SRILEC USP support or basic rates increased to a level that would allow the small ILEC to earn an amount that would be considered a reasonable rate of return, except that the adjustment may not set a small ILEC's support level at more than 140 percent of the annualized support the provider received in the 12-month period before the date of the adjustment.
 - (2) **Category 2** – A small ILEC that has a reported or commission-staff adjusted rate of return in Category 2 will be considered to be earning a reasonable rate of return and will not be eligible to file for an adjustment to its SRILEC USP support except as described in subsection (h)(2)(B) of this section. The commission may not

initiate a proceeding against a small ILEC that has a reported or commission-staff adjusted rate of return within Category 2.

- (3) **Category 3** – For a small ILEC that has a reported or commission-staff adjusted rate of return in Category 3, the commission staff may initiate a proceeding to review and adjust the small ILEC’s SRILEC USP support or basic rates to adjust the small ILEC’s rate of return into the reasonable rate of return range. A small ILEC that has a commission-staff adjusted rate of return in Category 3 is not eligible to file for an adjustment to its SRILEC USP support except as described in subsection (h)(2)(B) of this section.

(h) **Contested case procedures.**

- (1) **Documents to be submitted.** At a minimum, the following information must be provided by a small ILEC in a contested case proceeding, irrespective of whether such case is initiated by a small ILEC or commission staff:
- (A) all the data required by subsections (e) and (f) of this section;
 - (B) responses to commission staff’s requests for information in connection with the review of each small ILEC’s annual report;
 - (C) the requested SRILEC USP support or rate adjustments; and,
 - (D) testimony and workpapers necessary to support the requested adjustments.
- (2) **Qualification for contested case proceeding.**
- (A) **Category 1 small ILECs.** A small ILEC in Category 1, as identified in subsection (f)(3) of this section, may file an application that is eligible for administrative review or informal disposition to request an adjustment to its

SRILEC USP or basic rates to allow the company to earn a reasonable rate of return.

- (B) **Category 2 or Category 3 small ILECs subsequent to rate of return adjustment by commission staff.** A small ILEC that has a reported rate of return in Category 1 or Category 2, as identified in subsection (f)(3) of this section, but that has a commission-staff adjusted rate of return in Category 2 or Category 3, may file a petition to contest the commission-staff adjusted rate of return and may also request an adjustment to its SRILEC USP support or basic rates in the same proceeding. A small ILEC that has a reported rate of return in Category 2 but because of commission-staff adjustments the small ILEC is in Category 3, may file a petition to contest the commission-staff adjustments. However, the small ILEC may not request an adjustment to its SRILEC USP support or basic rates.
- (C) **Category 3 small ILECs.** A small ILEC in Category 3, as identified in subsection (f)(3) of this section, is subject to a commission staff-initiated proceeding to review the company's annual report and reported rate of return, must submit the information listed in paragraph (1) of this subsection.
- (3) **Notice.** Each small ILEC that files a contested case proceeding will provide notice as required by §22.55 of this title (relating to Notice in Other Proceedings). At a minimum, notice will be published in the *Texas Register* and will be provided to the Office of Public Utility Counsel. Each Category 1 small ILEC that files an application under this section must provide notice to its customers that the company

may be required to increase its rates as part of the adjustment to have its annual SRILEC USP support increased.

- (4) **Burden of proof.** A small ILEC will bear the initial burden of production and the burden of persuasion.
 - (5) **Timing to file a subsequent contested case.** Once the commission issues an order in a contested case under this section, the small ILEC and commission staff may not file a subsequent contested case before the third anniversary of the date on which the small ILEC's most recent application for adjustment is initiated, unless good cause is proven.
- (i) **Confidentiality of information.**
- (1) A report or information that a small ILEC is required to provide to the commission under subsection (e) of this section is confidential and not subject to disclosure under Chapter 552, Government Code.
 - (2) A third party may only access confidential information filed pursuant to subsection (h) of this section, or proceedings related to that filing, if the third party is subject to an appropriate protective order.
 - (3) This subsection does not apply to a subsequent contested case initiated under subsection (h) of this section, and no claim of confidentiality shall arise from this subsection in such a subsequent contested case.

- (j) **Commission adjustment of the small ILEC's revenue requirement and SRILEC USP support.**
- (1) **Revised revenue requirements.**
- (A) In a proceeding conducted in accordance with subsection (h) of this section, the commission will determine the small ILEC's new revenue requirement necessary to allow the company to earn a reasonable rate of return; however, the commission may not set a small ILEC's support level at more than 140 percent of the annualized support the small ILEC received in the 12-month period before the date of the adjustment.
- (B) A small ILEC that is in Category 1 cannot request an increase in the SRILEC USP support that would result in a rate of return greater than the minimum of the reasonable rate of return. In a proceeding for a small ILEC in Category 3, a small ILEC or commission staff may not request a decrease in the SRILEC USP support that would result in a rate of return greater than the maximum reasonable rate of return.
- (2) **SRILEC USP support payments to small ILECs.** The commission will determine the amount of adjustment to the annual SRILEC USP support or basic rates for the small ILEC that will be needed to meet the new revenue requirement identified in this paragraph. The commission will determine the fixed monthly support payment for a small ILEC by dividing the annualized SRILEC USP support by 12. Each small ILEC that has SRILEC USP support adjusted under this section shall provide the TUSF administrator with a copy of the final order indicating the adjusted amount of SRILEC USP support.

- (3) **SRILEC USP support payments to ETPs other than small ILECs.** The SRILEC USP support for ETPs other than a small ILEC will be determined by calculating the per-line support for each small ILEC's study area based on the most recent monthly support using December line counts for the small ILEC. The payment to each ETP other than a small ILEC will be calculated by multiplying the computed per-line amount for the given small ILEC study area by the number of eligible lines served by the ETP in such study area for the month.
- (k) **Miscellaneous items.**
- (1) **Federal Universal Service Fund (FUSF) support.** The amount of annual FUSF support received by the small ILEC that is considered to be an intrastate expense adjustment under Part 36 of the FCC's rules or by FCC order, regardless of the category of FUSF support, will offset the total intrastate expenses and be reflected as such in the small ILEC's annual report. The timing of any FUSF support will be considered when making a determination under subsection (j) of this section.
- (2) **Recovery of FUSF support from the TUSF in accordance with PURA §56.025.** The amount of FUSF support recovered from the TUSF in accordance with PURA §56.025 that is considered an intrastate expense adjustment under Part 36 of the FCC rules or by FCC order, regardless of the category of FUSF support or type of budget control mechanism placed on FUSF support, will be shown as an offset to the total intrastate expenses in the small ILEC's annual report. The timing of any recovery of FUSF support from the TUSF in accordance with PURA §56.025 and

the timing of any true-ups must be considered when making a determination under subsection (j) of this section.

- (3) **Commission authority.** Nothing in this section prohibits the commission from conducting a review in accordance with PURA, Chapter 53, Subchapter D.

- (l) **Treatment of federal income tax expense.**
 - (1) **Accumulated deferred federal income taxes (ADFIT).**
 - (A) For a small ILEC investor-owned utility (IOU) subject to federal income tax, the IOU must record on its books a regulatory liability for amounts of excess ADFIT resulting from the Tax Cuts and Jobs Act of 2017 (TCJA), in accordance with the commission's order in Project No. 47945. An IOU must include this information on the annual report required by this section. For the purposes of this section, excess ADFIT is defined as the difference between the amount of ADFIT on the IOU's books after incorporating changes from the TCJA and the amount of ADFIT that would have been on the IOU's books had the tax changes in the TCJA not occurred.
 - (B) At such time that commission staff files a memorandum for the commission to categorize the IOUs' rate of return for 2017, the IOUs will stop recording on the books the regulatory liability for excess ADFIT.
 - (C) IOUs will either amortize the excess ADFIT regulatory liability over a period not to exceed five years or allow it to reverse along with the associated ADFIT according to the transaction that resulted in the ADFIT.

(2) **Current federal income tax expense.**

- (A) For an IOU subject to federal income tax, the IOU must record on its books a regulatory liability for amounts of excess current federal income taxes resulting from the TCJA, in accordance with the commission's order in Project No. 47945. An IOU must include this information on the annual report required by this section. For purposes of this section, excess current federal income tax expense is defined as the difference between the amount of revenue collected under current rates related to current federal income tax expense and the amount of revenue related to current federal income tax expense that should have been collected under rates reflecting changes in the TCJA.
- (B) At such time that commission staff files a memorandum for the commission to categorize the IOUs' rate of return for 2017, the IOUs will no longer record on the books the regulatory liability for excess current federal income tax expense.
- (C) An IOU will amortize the regulatory liability for the excess current federal income tax expense over a period not to exceed five years.
- (D) An IOU will adjust its 2017 reported financial information to reflect the amount of current federal income tax expense for 2017 calculated as if the terms of the TCJA had applied to 2017 operations to calculate potential support from the SRILEC USP.

This agency hereby certifies that the proposal has been reviewed by legal counsel and found to be within the agency's legal authority to adopt.

**ISSUED IN AUSTIN, TEXAS ON THE 30th DAY OF MAY 2018 BY THE
PUBLIC UTILITY COMMISSION OF TEXAS
ADRIANA A. GONZALES**

q:\cadm\txr-rules management\rules\rulemaking projects\ch 26 telecom\47xxx\47669\47669 pub.docx