

CHAPTER 26. SUBSTANTIVE RULES APPLICABLE TO TELECOMMUNICATIONS SERVICE PROVIDERS.

Subchapter P. TEXAS UNIVERSAL SERVICE FUND.

§26.407. Small and Rural Incumbent Local Exchange Company Universal Service Plan Support 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).
- (b) **Application.** 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)).
- (c) **Definitions.** The following words and terms, when used in this section 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 Small and Rural Incumbent Local Exchange Company Universal Service Plan 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 factors 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 Small and Rural Incumbent Local Exchange Company Universal Service Plan 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) **Deadlines for annual reports.** 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 the form prescribed by the commission that is 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 a small ILEC elects to participate in this section. Subsequent annual reports must be filed no later than September 15 of each year. All annual reports must be related to the most recent calendar year prior to the filing of the annual report.
 - (2) **Contents of annual report.** The annual report filed by a small ILEC under this subsection must include information on the following:
 - (A) summary of revenues and expenses;
 - (B) all revenue, expense, and capital accounts;

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- (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 (for investor-owned utilities);
 - (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 in subsection (e)(2); and
 - (L) an authorized official's signature.
- (3) **Cost allocation manual.** The small ILEC must provide its full and complete cost allocation manual as part of the annual report specified by paragraph (2) of this subsection.
- (4) **Operational information.** By September 15, 2024, and on an annual basis thereafter, a small ILEC must file with the commission the following information regarding the provider's operations that are regulated by the commission:
- (A) total operating revenues;
 - (B) total operating expenses;
 - (C) total operating tax expense;
 - (D) rate of return;
 - (E) total invested capital; and
 - (F) network access revenue.
- (5) The operational information specified by paragraph (4) of this subsection must be filed as part of a small ILEC's annual report specified by paragraph (2) of this subsection.
- (A) A copy of the operational information specified by paragraph (4) of this subsection must be filed publicly with the commission. The public filing is prohibited from being filed confidentially in accordance with PURA §56.032(k).
 - (B) A small ILEC must provide reconciled information to the extent the operational information specified by paragraph (4) of this subsection is deficient or, where applicable, does not match the information provided in a small ILEC's annual report.
 - (C) To the extent that commission staff determines the operational information is deficient, the small ILEC must provide the reconciled information to the commission in a public filing prior to the deadline prescribed by the presiding officer.
- (f) **Commission staff's review of annual reports.** An annual report 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.

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- (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 subsection.
- (g) **Treatment of small ILECs based on rate of return categories.** Each category of ILEC 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 Small and Rural Incumbent Local Exchange Company Universal Service Plan 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. Any rate adjustments may not adversely affect universal service.
 - (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 Small and Rural Incumbent Local Exchange Company Universal Service Plan 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 Small and Rural Incumbent Local Exchange Company Universal Service Plan 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

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to file for an adjustment to its Small and Rural Incumbent Local Exchange Company Universal Service Plan 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, regardless of whether such case is initiated by a small ILEC or commission staff. Any proceeding filed under this section in which a party has intervened and requested a hearing is a case initiated by a small ILEC or commission staff and the filing requirements listed below apply to such cases.
 - (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 Small and Rural Incumbent Local Exchange Company Universal Service Plan 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 Small and Rural Incumbent Local Exchange Company Universal Service Plan 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 Small and Rural Incumbent Local Exchange Company Universal Service Plan 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 Small and Rural Incumbent Local Exchange Company Universal Service Plan support or basic rates. Any proceeding that is initiated by a small ILEC to protest a reclassification and in which a party has intervened and requested a hearing is a case initiated by a small ILEC and the filing requirements listed below apply to these cases.
 - (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 Small and Rural Incumbent Local Exchange Company Universal Service Plan support increased.
- (4) **Burden of proof.** A small ILEC will bear the initial burden of production and the burden of persuasion.
- (5) **Timing for contested cases.** The commission will grant or deny an application filed under subsection not later than 120 days after the date a sufficient application is filed. The

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commission may extend the deadline upon a showing of good cause. The application will be processed in accordance with the commission's rules applicable to docketed cases.

- (6) **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 according to subsection (h) of this section, or a proceeding 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 will arise from this subsection in such a subsequent contested case.
- (j) **Commission adjustment of the small ILEC's revenue requirement and Small and Rural Incumbent Local Exchange Company Universal Service Plan 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, nor may the rate adjustment adversely affect universal service.
 - (B) A small ILEC that is in Category 1 cannot request an increase in the Small and Rural Incumbent Local Exchange Company Universal Service Plan 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 Small and Rural Incumbent Local Exchange Company Universal Service Plan support that would result in a rate of return greater than the maximum reasonable rate of return.
 - (2) **Small and Rural Incumbent Local Exchange Company Universal Service Plan (SRIUSP) support payments to small ILECs.** The commission will determine the amount of adjustment to the annual SRIUSP 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 SRIUSP support by 12. Each small ILEC that has SRIUSP support adjusted under this section must provide the TUSF administrator with a copy of the final order indicating the adjusted amount of SRIUSP support.
- (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 and Part 54 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.

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- (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 and Part 54 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.
- (1) **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 rule. 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) 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. An acceptable alternative calculation of an appropriate regulatory liability for purposes of this rule is the difference in the current period federal income tax expense calculated under the TCJA and the amount that would have been calculated under the federal tax code immediately preceding 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 accrue 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 supplement 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 Small and Rural Incumbent Local Exchange Company Universal Service Plan. The IOU will report this information as a proposed adjustment.
 - (3) This subsection will expire on December 31, 2019. Any amortization of a regulatory liability resulting from application of this subsection would continue until completed.