

MAINTAINING UNIVERSAL SERVICE IN TEXAS

Recent Legislation, Oversight and Viability of the
Texas High-Cost Programs

By

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March 2021

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Introduction

About the Authors: In 2016, the authors of this new report, Michael J. Balhoff and Bradley P. Williams, prepared a 90-page comprehensive review (“2016 Report”) of Texas Universal Service that was sent to the members of the Texas Legislature.

Mr. Balhoff and Mr. Williams are financial professionals who have focused for more than 50 combined years on advising companies and institutional investors concerning major strategic decisions, valuations, divestitures and acquisitions, as well as regulatory advice related to policy matters affecting rural communications companies across the United States. In addition to working on a wide variety of financial assignments for carriers that serve in 90 percent of the states, the authors have been invited to provide briefings concerning rural telephony to the White House, the U.S. Congress (Senate and House), the Federal Communications Commission (“FCC”), the Department of Agriculture, the Universal Service Administrative Company, and a variety of other groups with federal responsibility. They also have testified on rural telephony in state proceedings in Alabama, Alaska, California, Colorado, Iowa, Maine, Minnesota, Nebraska, New Hampshire, Pennsylvania, South Carolina, Texas, Vermont, and Washington.

Authors’ Note: The purpose of this new report is to update Texas policymakers regarding universal service funding (“USF”) as it pertains to the Texas Universal Service Fund (“TUSF”). The authors will not restate the detailed data provided in the 2016 Report except to the extent that summary descriptions aid in the presentation of new information about TUSF. *As such, this update focuses on new Texas legislation and regulatory oversight of the TUSF as it affects the forty-four small Texas carriers that each serve less than 31,000 access lines in the State, and the four mid-size carriers that have been receiving TUSF.* Those TUSF-recipients are important providers of telecommunications infrastructure and services to customers who rely on voice telephone services across vast parts of the State. Given the high costs to build, maintain, and operate in low-density regions as required by regulation, the carriers and their customers are significantly dependent on TUSF support.

This update focuses on new Texas legislation and regulatory oversight of the TUSF as it affects the forty-four small Texas carriers that each serve less than 31,000 access lines in the State, and the four mid-size carriers that have been receiving TUSF.

Executive Summary

In 2016, the authors provided an in-depth study on the state of the Texas Universal Service Fund (“TUSF”). Based in part on the 2016 Report and input from all stakeholders, the Legislature enacted extensive compromise legislation to provide the required levels of TUSF support while enhancing transparency, review, and oversight of the providers receiving that support. This 2021 update builds upon that 2016 Report to address important legal and regulatory developments over the last four years, with a focus on data related to:

- the critical need for financial support to ensure the provision of universal telephone service to rural customers in Texas,
- the performance of recent compromise legislation in accomplishing its intended goals of maintaining TUSF support where needed while providing greater oversight and ability to regulate support levels, and
- the capability of the recently enacted TUSF legislation to work as intended to provide universal service throughout the State of Texas.

As demonstrated throughout this report, there continues to be a need for TUSF. The policy and mechanisms assure service in rural and high-cost areas of the state that would not otherwise have service, as those regions are uneconomic-to-serve without TUSF support.

WHAT IS TUSF?

- **TUSF is a multi-program fund mandated by the Texas Legislature and administered by the Public Utility Commission of Texas (“PUCT”)** to ensure that all Texans have access to reliable, affordable telephone service, regardless of income, disability, or location. TUSF provides the financial mechanisms to accomplish the policy commitment to a statewide “universal communications network.” Recognizing the benefit of critical communications infrastructure, Texas policymakers established TUSF to help pay for the underlying costs of economic and social connectivity in low-density regions, with a clear goal of benefiting all Texas customers—urban and rural, residential and business.
- **TUSF pays for certain high costs of a ubiquitous statewide telephone network** and is funded through cost-based charges applied to all voice telephone service customers in Texas. The charges appear on customers’ communication bills and the accumulated funds are distributed to offset the extraordinarily high costs of rural network investment necessary to serve customers in certain rural regions.
- **TUSF is not a tax or a subsidy** that benefits certain telecommunications carriers. It is a system created to accomplish legislative policy in paying for connectivity services for all Texas. The TUSF policy and mechanisms are a clearly-articulated commitment that ensures telecommunications services for the state of Texas and, at the federal level, for the nation. Because investment, maintenance and operating costs vary widely in urban and rural areas, as well as in benign and in challenging terrains, policymakers have rightly understood that a universal network—which creates value for all participants on the network—must be supported financially by all customers who benefit economically and socially from that integrated network. It is important to note that rural telecommunications companies could focus on

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relatively more concentrated, low-cost-to-serve customer bases—avoiding the highest cost, lowest density areas. However, federal and state policymakers have established provider-of-last-resort (“POLR”) obligations that require certain carriers to serve uneconomic regions as part of the design to achieve “universal” communications networks. Offsetting those high costs is a USF regime in which the policymaker pledges to support the obligated carrier through reimbursement of extraordinarily high costs. The definition is critical, as it focuses on why TUSF is implemented—for the benefit of all Texas customers who, in urban and rural areas, are required to assist in funding a universal statewide network.

WHY IS THE TUSF NECESSARY?

- **All Texans benefit from being able to place and receive calls to all other Texans.** Since its creation in 1987, TUSF has helped support a robust and well-maintained statewide telecommunications network. While the high-cost programs in TUSF support basic voice telephone services, the critical network infrastructure also enables other advanced telecommunications services such as wireline broadband Internet services. However, since TUSF is focused on voice-based services, this report concentrates on those regulated voice services and on the mechanisms that assure compliance with the universal service policy of the Texas Legislature.
- **Installing and maintaining the Texas telecommunications network is expensive** and the cost is uneven from one region to another, primarily due to population density factors. In Texas, with the assistance provided by TUSF small and rural providers have invested well over \$1 billion on infrastructure expansion and improvements in the last decade to provide communications services to 1.3 million households and 2,200 schools, colleges, government buildings, and other anchor institutions in territory covering over 148,000 miles of the state – an area larger than 47 other states.
- **Voice service rates cannot cover the costs of building a statewide network that provides telephone service in sparsely populated areas, so support remains critical to keeping Texans connected.** Two of the TUSF programs—the “high-cost programs”—reimburse the costs of providing voice service to customers in lower-density rural areas. The TUSF high-cost programs are the Texas High-Cost Universal Service Plan (“THCUSP”) and the Small and Rural Incumbent Local Exchange Carrier Universal Service Plan (“SRILEC USP”). Illustrating the density-related challenge that renders certain areas uneconomic to serve without support, the 43 reporting small Texas carriers receiving TUSF under SB 586 (“SB 586 Reporting Carriers”) served in 2019 an average and median number of customers per square mile of approximately 4.9 and 2.0, respectively.¹
 - The PUCT reviews the filings of SB 586 Reporting Carriers (which are “SRILEC”) carriers. PUCT staff reported in December 2020 that 32 of the 43 SB 586 Reporting

Thirty-two of the 43 SB 586 Reporting Carriers are earning a rate of return on regulated revenues below the legislatively-approved rate band, 9 carriers are generating returns within the rate band, and 2 are above the rate band . . . More ominous, 12—or 37.5 percent—of the 32 underearning carriers have negative returns.

¹ There are 44 small Texas carriers, but one—Southwest Arkansas Telephone Cooperative—did not elect to participate in the mechanism created by SB 586. Accordingly, this report will reference the 43 carriers (SB 586 Reporting Carriers”) that did elect to be regulated under SB 586. The square mileage for each carrier is based on information provided to the State and differs from the approximate figures used by the FCC in its 2014 Quantile Regression Analysis, as relied upon in the authors’ 2016 Report, pp. 21-22.

Carriers are earning a rate of return on regulated revenues below the legislatively-approved rate band (6.75 percent to 11.75 percent). Nine of the reporting carriers are generating rates of return within the rate band deemed reasonable, while only two are above the rate band and could be reviewed for a rate adjustment.

- More ominous, 12—or 37.5 percent—of the 32 underearning carriers have negative rates of return on regulated revenues with an average return of -8.24 percent. And, those carriers with negative returns accounted for 28 percent of the 43 SB 586 Reporting Carriers.
- Based on the authors’ review, experience, and data in this report, customers in high-cost areas across Texas are likely to be at risk of losing voice telephone service if support is reduced. At best, without the assistance of sufficient TUSF, carriers may be compelled to eliminate telephone service in the most-costly service regions and commit to dramatically reduced network investment. The predictable result will be that customers across large regions of Texas will be left without wireline *and* wireless communications services—that depend on the underlying wireline network—an outcome that is likely to be difficult to reverse in a cost-effective manner in the foreseeable future.

SUMMARY LEGISLATIVE HISTORY OF THE TUSF

- **The PUCT’s ability to manage the TUSF is at an all-time high.** On an annual basis, the PUCT receives from the recipients of TUSF information and data that are more extensive and detailed than that collected by any other state commission surveyed by the authors across the country. Those data and annual filings are pursuant to the Texas Public Utility Regulatory Act (“PURA”) § 56.032 proceedings and 16 Texas Administrative Code (“TAC”) § 26.407.
- **New annual reports provide unprecedented detail.** As a result of the Texas Senate Bill (“SB”) 586 legislation in 2017, small telecommunications providers began providing to the PUCT new annual reports of unprecedented length and detail. In the filings, the small providers account for every dollar earned and spent. The PUCT requires that the carriers respond to detailed data requests about those reports and has the power to require the carriers to submit to rate cases or TUSF support adjustment proceedings if problems or concerns are identified. The THCUSP mid-sized providers also file detailed annual earnings monitoring reports for PUCT review.
- **Carriers are highly accountable.** The authors have reviewed an extensive sampling of the more than 80,000 pages of reports and supporting materials filed in 2020 in response to PUCT data requests.
 - Like the PUCT and its staff, the authors’ review has not identified any material issues or improper use of TUSF support. On the contrary, the evidence is that the TUSF-carriers are highly accountable with respect to accomplishing the Legislature’s stated policy objectives. If there is a “weakness” in the mechanism, it can be argued that the policy for support is “unfairly” limited when an underearning carrier’s rate of return cannot immediately be adjusted to a level within the Legislature’s statutory rate band.² But it is

It is noteworthy that there is no PUCT allegation that there is a misallocation of support or that the need for TUSF is overstated.

² Sec. 56.032(h): “A small provider whose return is not reasonable under Subsection (f) because the return is more than three percentage points below the rate of return as defined in this section may file an application that is eligible for administrative review or informal disposition to adjust support or rates to a level that would bring the small

noteworthy that there is no PUCT allegation that there is a misallocation of high-cost support or that the need for TUSF is overstated.

- With respect to potential cross-subsidizations of unregulated expenses with regulated earnings, the PUCT has not identified or alleged any improper application of the telecommunications accounting rules that prevent cross-subsidization. The applicable Texas rules require that the carriers maintain a voice telephone network, and the costs and expenses of the carriers' networks appear appropriate. To the extent the network is used to provide broadband services—which are required by and subject to federal regulation, including cost allocation rules—there is no evidence that the carriers are allocating interstate costs that are more than what is required for a voice network to their intrastate telephone operations.
- The authors believe, after a review of the filings, that the **TUSF recipients are investing their support to enable the provision of voice services in rural and high-cost areas in Texas, consistent with Texas statutory requirements.**

CONCLUSIONS AND RECOMMENDATIONS

- Based on the carrier filings to the PUCT, TUSF recipients are following applicable laws and rules, and continue to be dependent on TUSF support to remain financially sound and continue to serve rural Texans and the broader population that interconnects with those regions. **Without predictable and sufficient TUSF, there is compelling evidence of the risk that Texans—urban and rural—may no longer benefit from a reliable statewide telecommunications network.**
- The authors' experience in the telecommunications industry leads to the conclusion that even a short-term underfunding of TUSF puts at risk investment and service to customers, as well as the viability of carriers that require a stable revenue base and long investment horizons. The potential damage to the critical telecommunications network and the harm to customers would be difficult to reverse in a high-fixed cost business, such as telecommunications, where long-lived and costly assets must be maintained.
- Both the state and federal legal frameworks for universal service policy are directed toward assuring a statewide network through combined federal and state USF support. Underfunding TUSF is likely to result in damage to or failure of universal service for rural and other high-cost regions in Texas, and for Texans who depend upon connectivity to all areas of the State.

Even a short-term underfunding of TUSF puts at risk investment and service to customers, as well as the viability of carriers that require a stable revenue base and long investment horizons.

provider's return into the range that would be deemed reasonable under Subsection (f), except that the adjustment may not set a small provider's support level at more than 140 percent of the annualized support amount the provider received in the 12-month period before the date of adjustment. A rate adjustment under this subsection may not adversely affect universal service. Except for good cause, a small provider that files an application for adjustment under this subsection may not file a subsequent application for adjustment before the third anniversary of the date on which the small provider's most recent application for adjustment is initiated.”

What is TUSF?

The Texas Universal Service Fund is a policy-based program that assures that all the State’s residences and businesses, notably those in high-cost and low-density service areas, will have access to voice communications services at prices reasonably comparable to those charged in denser, lower-cost regions in the State. The TUSF dates back to 1987 when the Texas Legislature declared that . . .

. . . customers in all regions of this state, including low-income customers and customers in rural and high-cost areas, [shall] have access to telecommunications and information services, including interexchange services, cable services, wireless services, and advanced telecommunications and information services, that are reasonably comparable to those services provided in urban areas and that are available at prices that are reasonably comparable to prices charged for similar services in urban areas.³

Customers in all regions of this state. . . [shall] have access to telecommunications and information services . . . that are reasonably comparable to those services provided in urban areas and that are available at prices that are reasonably comparable.

MULTI-PROGRAM FUND MANDATED BY THE TEXAS LEGISLATURE

Today, TUSF includes eleven programs. As in the 2016 Report, this study is focused on “network-related support” which is provided by TUSF programs one through four below. [Figure 1](#) illustrates the composition of Fiscal Year (ending August 31) 2020 disbursements for network-related support.

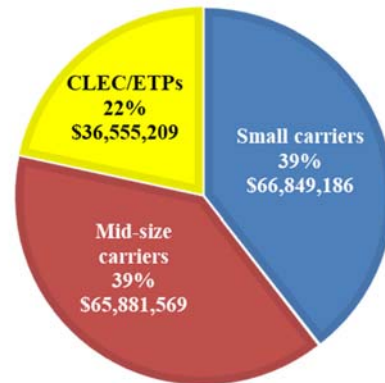
Programs for network-related support are:

1. Texas High-Cost Universal Service Plan supporting services provided by CenturyLink and Windstream Holdings, as well as other carriers providing competitive services in the regions where the four largest carriers (including AT&T Texas and Frontier) offer service (PURA §56.021(1))
2. Small and Rural ILEC Universal Service Plan supporting services provided by smaller SB 586 Reporting Carriers, Consolidated Communications, certain operating companies of CenturyLink and Windstream Holdings, as well as other carriers providing competitive services within these ILEC service territories (PURA §56.021(1))⁴
3. High-Cost Uncertificated Areas

Other high-cost assistance programs include:

4. PURA Support
5. PURA §56.025 – Federal Universal Service Fund Loss Recovery

FIGURE 1: FY 2020 TUSF NETWORK-RELATED FUNDING



³ PURA § 51.001(c)(d).

⁴ Guadalupe Valley Telephone Cooperative is a rate-of-return carrier that was unable to opt into SB 586 because it served more than 31,000 access lines on September 1, 2013.

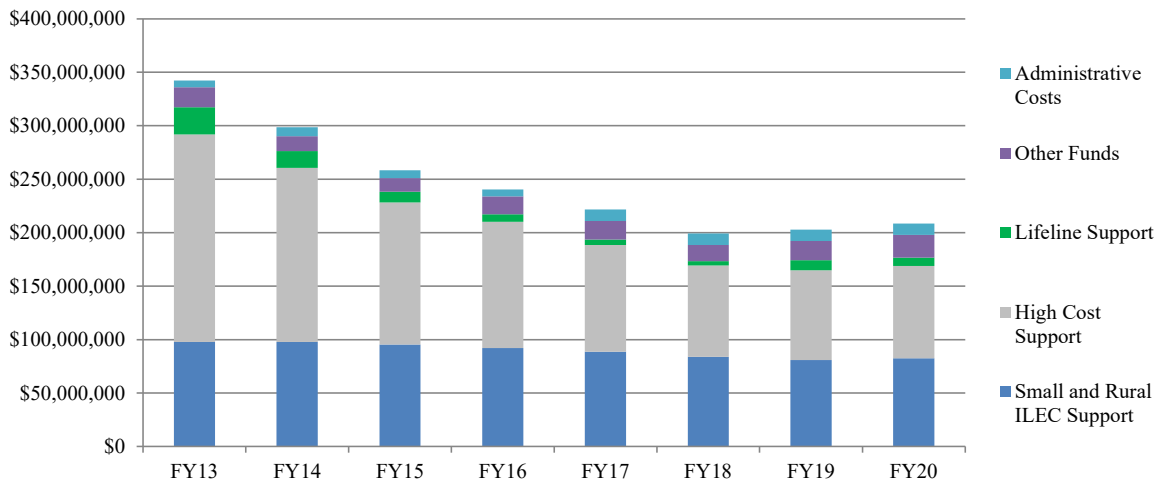
Social programs in direct support of customers with low incomes or requiring disability assistance, and providing support for eligible schools and libraries are:

6. IntraLATA (Schools & Libraries for non-58/59 companies) (PURA §56.028)
7. Lifeline (PURA §56.021(5-6))
8. Tele-Assistance Support
9. Texas Telecommunications Relay Service (PURA §56.021(2))
10. Specialized Telecommunications Assistance Program (STAP) (PURA §56.021(3))
11. Audio Newspaper Program (“ANP”) (PURA §56.021(9))

SUPPORT LEVELS TODAY

Figure 2 illustrates historical TUSF disbursements for fiscal years (“FY”) 2013 to 2020. The bottom blue bars are the SRILEC disbursements and the grey bars are THCUSP disbursements. At a quick glance, it is apparent that the amount of support provided through those two fund programs has generally contracted since 2013, with the reduced THCUSP disbursements the primary driver for the reduction in total support.

FIGURE 2: TEXAS UNIVERSAL FUND DISBURSEMENTS FY 2013 – FY 2020



Source: Solix Annual Reports.

Table 1 below offers more detailed data on the funding components of the various TUSF programs (excluding administrative costs that are included in the graphic above) over the same period. Total TUSF payments to carriers and other parties contracted from 2013 to 2020 at a -7.3 percent compound annual growth rate (“CAGR”). Total FY 2020 non-administrative disbursements for the eleven programs was approximately \$199.1 million, up slightly from FY 2019 disbursements of \$198.0 million but down significantly from FY 2013 disbursements of \$338.1 million. Total network-related support declined by 7.5 percent annually over the same seven-year period, driven by the elimination of support to large carriers and contraction in support for mid-size companies. In 2020, total network-related support was \$169.2 million compared with \$165.2 million in FY 2019 and \$293.2 million in 2013.

THCUSP and SRILEC support . . . has generally contracted since 2013, with the reduced THCUSP disbursements the primary driver for the reduction in total support.

For the smallest companies, support has remained relatively flat, rising from \$61.3 million in 2013 to \$66.8 million in 2020 and growing at a modest 1.3 percent CAGR over the period.

TABLE 1: TUSF DISBURSEMENTS 2013 TO 2020

	FY 2013	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020	CAGR '13-'20	Growth 2020 v. 2013
Network related Support										
Small companies										
SRILEC	60,204,130	61,575,946	62,553,444	63,067,237	63,579,656	63,736,371	63,658,824	66,629,188	1.5%	10.7%
IntraLATA	1,070,422	1,245,611	553,026	535,731	435,625	343,539	282,145	219,998	-20.2%	-79.4%
Total Small companies	61,274,552	62,821,557	63,106,470	63,602,968	64,015,281	64,079,910	63,940,969	66,849,186	1.3%	9.1%
Mid-size companies										
SRILEC	33,941,628	32,504,642	29,170,380	25,582,791	22,048,020	17,614,990	14,752,098	13,755,170	-12.1%	-59.5%
High Cost	104,818,310	90,752,748	79,772,947	69,846,078	63,253,322	55,879,426	52,835,187	52,126,400	-9.5%	-50.3%
IntraLATA	46,388	46,703	164,527	31,185	7,547	629	-	-	-	-100.0%
Total Mid-size companies	138,806,326	123,304,093	109,107,853	95,460,054	85,308,889	73,501,963	67,587,915	65,881,569	-10.1%	-52.5%
Large companies										
High Cost	62,361,739	44,372,166	25,781,749	20,876,794	8,627,658	-	-	-	-	-100.0%
Uncertificated	252	138	107	104	104	104	-	-	-	-100.0%
Total Large companies	62,361,991	44,372,304	25,781,855	20,876,898	8,627,763	104	-	-	-	-100.0%
CLEC/ETPs										
SRILEC	3,661,294	3,699,075	3,669,036	3,363,796	2,978,375	2,573,755	2,395,753	2,083,353	-7.7%	-43.1%
High Cost	26,929,063	27,769,898	27,429,295	27,433,646	27,973,160	29,548,047	31,080,411	34,268,890	3.5%	27.3%
Uncertificated	166,957	176,872	166,690	165,475	169,894	204,952	207,604	202,966	2.8%	21.6%
Total CLEC/ETPs	30,757,314	31,645,846	31,265,021	30,962,916	31,121,429	32,326,754	33,683,768	36,555,209	2.5%	18.9%
Total network-related support	293,200,183	262,143,800	229,261,200	210,902,836	189,073,362	169,908,731	165,212,652	169,285,964	-7.5%	-42.3%
Other Support										
Audio Newspaper Program	416,067	398,200	476,292	447,954	448,650	477,227	469,238	468,275	1.7%	12.5%
FUSF	2,203,273	6,337,443	1,929,033	1,734,311	1,485,247	4,113,491	5,890,873	1,226,992	-8.0%	-44.3%
Lifeline Support	25,354,403	15,437,763	9,804,461	6,996,101	5,185,293	3,935,309	9,520,860	7,814,510	-15.5%	-69.2%
PURA	4,747,877	3,334,924	1,949,455	1,947,730	1,942,610	2,128,249	2,319,012	2,319,012	-9.7%	-51.2%
Specialized Telecom Assistance	7,472,660	5,623,939	6,310,428	11,223,461	11,905,219	9,931,127	12,539,781	16,506,097	12.0%	120.9%
Tel-Assistance Support	7,496	6,452	4,783	4,206	3,779	2,697	2,173	1,520	-20.4%	-79.7%
Telecommunications Relay Service	4,676,258	3,320,035	3,162,660	2,442,439	2,225,014	2,050,063	2,034,248	1,511,336	-14.9%	-67.7%
Total other support	44,878,034	34,458,756	23,637,113	24,796,203	23,195,812	22,638,164	32,776,185	29,847,743	-5.7%	-33.5%
Total FY support	338,078,217	296,602,556	252,898,313	235,699,039	212,269,174	192,546,895	197,988,837	199,133,707	-7.3%	-41.1%

Source: Solix Annual Reports.

COST-BASED CHARGES PAID BY ALL VOICE TELEPHONE SERVICE CUSTOMERS

The language in the PURA is prescriptive. PURA (Title II, Texas Utilities Code), Section 56.022 requires “a statewide uniform *charge* payable by each telecommunications provider [and hence each customer] *that has access to the customer base.*” [Emphasis added.] The concept is the same as in federal policy, as users of the network pay a *charge* for the costs to gain *access to the customer base* across a broader network.

Section 56.022 requires “a statewide uniform charge payable by each telecommunications provider [and hence each customer] that has access to the customer base.”

The state of Texas has an expansive telecommunications network across expansive low-density areas which encompass the largest rural population of any U.S. state.⁵ And, as is the case in 42 states, Texas customers’ monthly telecommunications bill includes a calculated charge that is, by design, part of the cost for the provision of statewide voice communications services.⁶

Later in this report, the authors provide data that demonstrate that per-customer network costs are different within denser service areas such as urban Dallas than in small communities such as Terlingua, Port Mansfield, or Huxley, or on the ranches in the Texas panhandle. Because a statewide

⁵ Susan Combs, *Texas in Focus: A Statewide View of Opportunities*, Texas Comptroller of Public Accounts, (Jan. 17, 2008); see Demographics, Exhibit 6, available at [Texas Demographics](#).

⁶ Sherry Lichtenberg, *State Universal Service Funds 2018: Updating the Numbers*, National Regulatory Research Institute, April 2019, available at [NRRRI State USF 2018](#), p. 3.

telecommunications network benefiting all Texas customers is the policy goal, customers in all parts of the state pay a distributed share of the high investment and operating costs in certain otherwise uneconomic-to-serve regions.

NOT A TAX OR SUBSIDY BUT A CHARGE TO PROVIDE A “UNIVERSAL” NETWORK

The Texas Legislature is clear about the goals of the State’s universal service policy which include the “wide availability of high quality, interoperable, standards-based telecommunications services at affordable rates” to assure “enhanced economic development” and the “improved delivery of education, health, and other public and private services.”⁷ As noted in the Texas Rural Impact Report 2013 . . .

No community [or state] can grow without access to infrastructure. Water, transportation, housing, energy and telecommunications are examples of critical infrastructure that must be in place to support businesses and families in rural Texas Although communities can supplement local resources with state and federal programs, ultimately infrastructure needs must be met with a local, self-sustaining strategy.⁸

TUSF IS NOT A “TAX”

Understanding the essential relationship between TUSF and network-related statewide costs is fundamental to recognizing certain commonly-cited distortions or misrepresentations of the TUSF.

TUSF is not a tax. The word “tax” is a “loaded” term and leads wrongly to the conclusion that the funding of TUSF is a contribution to state revenues, often mistakenly represented as a benefit directed at rural customers who are not paying the costs for *their* local network. When TUSF is characterized as a “tax,” parties can argue that the line-item on their bill is a discretionary fee that legislators should appropriate—or not appropriate. At the state and federal levels, however, no “appropriations” or treasury-related activity occurs with respect to universal service policy because USF is not and never was a tax. Universal service support involves the direction of funds that offset real costs for a universal statewide network that improves the connectivity for all the State’s citizens. And USF is not a supplemental redirection of funding for the benefit of only certain low-density regions. In fact, TUSF renders benefits to Austin, Houston and Dallas whose implied network costs are actually higher than those incurred within the city limits.

The economic concept supporting the policy of a universal communications network is referred to as “network externality,” the theory being that the more homes and businesses connected to a robust and wide communication network, the more valuable the network is to each user. When TUSF is characterized as a tax, the logical next step is to argue to regulators or legislators that the funding can be raised or lowered or constrained, depending on the policymakers’ judgment. If the funding of TUSF, however, is properly understood as a cost pass-through, the level of those costs is rooted in real expenditures related to critical network services required to fulfill the policy goal. It becomes more difficult to argue that the costs for serving uneconomic areas should not be paid, or that they should be subject to annual modifications in appropriations priorities.

If the policy of USF is properly understood as a cost pass-through, the level of those costs is rooted in real expenditures related to critical network services. And it becomes more difficult to argue that those costs should not be paid.

⁷ PURA § 51.001(d)(2).

⁸ Commissioner Todd Staples, *Texas Rural Impact Report 2013*, Texas Department of Agriculture, April 18, 2013, available at [Texas Rural Impact Report 2013](#).

TUSF IS NOT A “SUBSIDY”

Opponents of TUSF often wrongly characterize the payments as “subsidies” when arguing against the program. “Subsidies” are, in the strictest sense, assistance to a troubled business or an economic sector to help the producers or the industry remain viable, including against other competitors, which are often foreign entities. However, TUSF is not fundamentally “assistance” to help a struggling carrier or sector, nor is it a protection for the carriers. In fact, wireline carriers can have successful businesses if they are able to concentrate their operations on profitable services and selective customer clusters. If there is a “protection,” it is to assure that *customers* are served in regions where no provider—on its own—could justify the investment and ongoing costs required to operate. The “support” payments are part of a public/private partnership—clearly established in federal and Texas legislation—between carriers and policymakers who choose to “assure funding” for a *product-set to be provided to customers* in high-cost regions. The distinction is important, as *USF is a policy commitment to customers, not to companies*, with the assurance that underlying high costs will be paid by the entire customer base that relies on and derives value from connection to a broad telecommunications network. The carriers, in exchange for offsets through the TUSF for uneconomic investment and operations, provide otherwise-uneconomic services that benefit customers in high-cost regions as well as customers elsewhere who interconnect with those customers.

In sum, because costs vary widely in urban and rural areas, in benign and in challenging terrains, policymakers have rightly understood that a network must be supported by all customers who benefit economically and socially from that network. Accordingly, the real costs of a ubiquitous network are collected from all customers and allocated, based on careful review of the costs, to assure the preservation of that universal network. USF is not a temporary assistance or subsidy but is an enduring mechanism to properly allocate network costs across the broader universe of customers—for the benefit of all *customers, not companies*.

USF is not a temporary assistance or subsidy but is an enduring mechanism to properly allocate network costs across the broader universe of customers—for the benefit of all customers, not companies.

TEXAS CONTRIBUTION FACTOR ON EACH CUSTOMER’S BILL

The federal Telecommunications Act of 1996 (“Telecommunications Act”) in Section 254(f) requires that any state that establishes an explicit universal service support mechanism must fund such a program through contributions from every telecommunications provider that provides intrastate telecommunications services, and do so on an equitable and non-discriminatory basis.⁹

RECENT HISTORY OF TEXAS CONTRIBUTION FACTOR

The Texas Legislature enacted a universal service support contribution requirement in PURA.¹⁰ The Legislature gave the PUCT discretion to implement the TUSF contribution methodology, and in 2000, the PUCT implemented the current revenue-based approach. Under it, the TUSF assessment rate is calculated by estimating the size of the statewide voice pool of revenues, and then determining a percentage of that pool (today 3.3 percent) after excluding 911 service fees to meet the obligation to offset high rural costs. Because in recent years THCUSP support is no longer provided to AT&T Texas, Inc. (“AT&T”) or Frontier

⁹ 47 U.S.C. § 254(f).

¹⁰ PURA § 56.022. “UNIFORM CHARGE. (a) The universal service fund is funded by a statewide uniform charge payable by each telecommunications provider that has access to the customer base. (b) A telecommunications provider shall pay the charge in accordance with procedures approved by the commission. (c) The uniform charge is on services and at rates the commission determines. In establishing the charge and the services to which the charge will apply, the commission may not: (1) grant an unreasonable preference or advantage to a telecommunications provider; (2) assess the charge on pay telephone service; or (3) subject a telecommunications provider to unreasonable prejudice or disadvantage.”

Communications Corporation (“Frontier”) and due to other adjustments, the current TUSF contribution factor has been reduced from the 2012 TUSF surcharge of 4.3 percent. In fact, as a result of lesser funding obligations, Texas’ universal service contribution factor has trended lower since it peaked at 5.65 percent in 2004.¹¹

Today, however, the TUSF contribution factor is attracting more scrutiny and debate. The factor has not been adjusted since 2014, even as assessable revenues continued to shrink. On May 13, 2020, the PUCT Chairman noted in a memorandum that the TUSF Administrator forecasted that as early as December 2020 that there may be insufficient revenue to fund all existing TUSF programs.¹² The memorandum explains that “[c]urrent revenue and expenditure projections indicate that the current assessment rate will need to be increased from 3.3 percent to 6.4 percent in June 2020 to keep the TUSF solvent through August 2021.”¹³ Then, on June 12, 2020, the PUCT rejected its staff’s Proposed Order to increase the contribution factor, even as the PUCT acknowledged that the TUSF would be unable to meet the projected support levels for Texas carriers serving high-cost areas and their customers (the “June 12 Decision”). The Commissioners directed the PUCT staff to “triage” by prioritizing allocation of TUSF funds to support low-income programs over high-cost programs.¹⁴

Subsequently, in response to letters from state congressional representatives, the PUCT Chairman clarified in a letter that she has “serious concerns” about “imposing” a “fee” on Texans during a pandemic.¹⁵ The letter states that “[t]he telecommunication companies have advocated that the increase in the fee [sic] would impact customers by approximately \$0.50 a month. If the assertions are correct, then the additional tax [sic] impacts across the State of Texas would be approximately \$100 million annually.”¹⁶

¹¹ Docket No. 21208, *Texas Universal Service Fund (TUSF) Administration*, Orders Changing TUSF Assessment (July 28, 2004; July 24, 2006; April 18, 2007; Aug. 8, 2008; Nov. 10, 2011; July 9, 2013; Dec. 18, 2014).

¹² *Review of TUSF Rate*, Project No. 50796, Commissioner Memorandum of Chairman DeAnn T. Walker at 1 (May 13, 2020), available at http://interchange.puc.texas.gov/Documents/50796_2_1065623.PDF: “In the 2nd quarter of 2020, the ending balance for the fund was \$96 million. Of that \$94 million reduction in the fund balance, \$75 million, or 80%, occurred in the past year. This change occurred because the taxable [sic] receipts related to the provision of telecommunication services by the companies was reduced by \$1 billion dollars from 2018 to 2019. The reduction occurred due to a declining number of access lines and because the telecommunication companies modified the calculation of the assessment to remove costs related to data, which comprise a larger portion of wireless bills than the provision of telecommunication services.”

¹³ *Id.* at 2.

¹⁴ *Review of TUSF Rate*, Project No. 50796, Open Meeting Tr. at 39:2-6 (Jun. 12, 2020) (Chair Walker: “[M]y position at this point would be to leave the Fund as it is but to direct Staff and Jay Stone, in particular, to begin paying out of the Fund to only fund lifeline projects so that those continue to be funded but to leave everything else as is.”); at 40:14-22: Commissioner Walker: “I think this is not a time when we should be raising taxes [sic] on people, particularly not . . . this almost irrational singling out of this group of people who we would be taxing [sic]. So, I agree with you. I think we leave it as is, and we ask Staff to get with Solix [the fund administrator] and figure out a way to triage . . . I’m certain the social welfare [non-network TUSF] programs are such a small piece of this that we can fund those with what we’re getting in forever.”

¹⁵ DeAnn Walker, Letter from the Public Utility Commission of Texas to the Honorable Charles Perry, July 30, 2020, available at http://interchange.puc.texas.gov/Documents/50796_34_1078072.PDF. In the letter, Chair Walker goes on to explain at 4 that “Total revenues from the TUSF have steadily declined since 2006, but fell abruptly in the second half of 2019. At that time, some cellular companies reassessed how much of their customer usage was from data versus voice. They reallocated a larger portion of each customer's bill to data and a smaller portion to voice. Because the voice portion of the bill was smaller, the amount paid to the TUSF decreased.”

¹⁶ *Id.* at 5.

The authors of this report do not address the legal issues surrounding the PUCT’s decision but note that there is litigation challenging whether the PUCT is justified in its failure to adjust the contribution factor and its decision to allow the TUSF to be underfunded. It is noteworthy, however, that the PUCT Chairman writes about her rationale which is a reluctance to raise a “tax” or a “fee” which is a characterization of the contribution factor that is contrary to federal or legislative language which focuses on offsetting policy-driven uneconomic costs of service by a pass-through “charge.” The modification of the terminology appears to be important, as it changes the essential nature of the cost-based charge that is shared across the users of the universal statewide network.

The alternative view is that USF is not a “tax” but a mechanism to meet PUCT-verified costs that are required to provide network services important to all Texans.

The characterization shifts the equity toward protecting financially-challenged customers who, according to the PUCT Chairman, should not be burdened with a higher “tax.” Of course, as discussed earlier, the TUSF contribution charge is not a “tax” but a mechanism to meet PUCT-verified costs that are required to provide policy-mandated communications services important to all Texans. In other words, it costs *all* customers across the state \$0.50 to have access to all service areas across the state. It is worth noting that the risk of critical network failure is likely to be a more serious outcome than a \$0.50 per customer increase to Texas consumer bills, particularly when Texans are relying upon telecommunications access to a degree greater than ever before.

FEDERAL CONTRIBUTION FACTOR

For perspective, the federal approach in determining a contribution factor that sufficiently funds federal universal service programs is essentially the same as the approach employed historically in Texas. And the federal contribution factor has consistently increased. The explanation for the federal increase is two-fold. The number of federal non-carrier network programs has increased, thus pushing the amount of required funding higher. Second, the base of voice-related revenues to which the contribution factor is applied in order to generate the required funding has been shrinking. That latter problem is one of the same challenges affecting the Texas program, where the shrinking size of the pool of revenues from which to draw TUSF in 2021 accounts for the potential increase in the contribution factor referenced above by Chairman Walker. To be clear, if the revenue pool is shrinking and the required funding amount is relatively stable, then the percentage factor applied to the smaller revenue pool will have to increase in order to generate the required funding.

Again, for perspective, the federal contribution factor has risen relatively consistently and then more sharply since 2018, as detailed in [Figure 3](#). But, in spite of the very high percentage level, the FCC has reaffirmed its commitment to sufficient funding of USF by assuring that the contribution factor generates the support required to meet the obligation to provide service to customers in uneconomic, low-density, high-cost areas.

[T]he FCC has reaffirmed its commitment to sufficient funding of USF by assuring that the contribution factor generates the support required to meet the obligation to provide service to customers in uneconomic, low-density, high-cost areas.

FIGURE 3: FEDERAL QUARTERLY USF CONTRIBUTION FACTOR



Source: Universal Service Administrative Company.

THE PROBLEM IS THE CONTRIBUTION METHODOLOGY

The fundamental problem is obvious. The rising contribution factor—nationally and in Texas—is *not* driven by the network fund requirements for providing universal service since the carrier network fund levels have remained stable or have declined in both the federal and state programs, respectively. The problem is that the total revenue pool from which support is derived—based on voice revenues of all customers—has been shrinking as communications service revenues have shifted notably toward data and away from voice. This is exacerbated in the case of the federal USF program, where universal broadband joined voice as a core supported service following the FCC’s Transformation Order of November 2011, but the FCC has not redefined the contribution pool to include all revenues associated with both voice and broadband services provided over the networks. Still, the nationwide high-cost network obligations for universal service have risen by an average annual rate of only 0.86 percent from 2010 through the first quarter of 2021.¹⁷

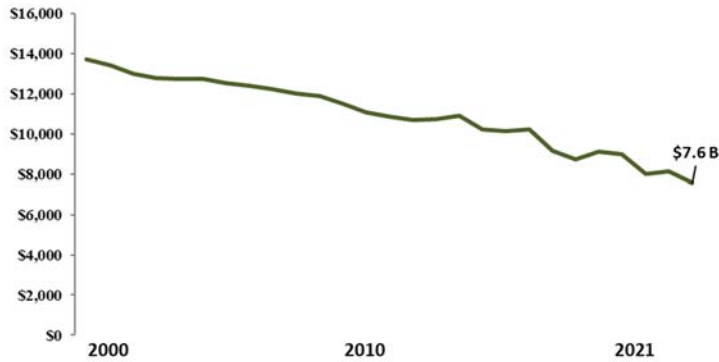
In Texas, high-cost TUSF supports voice telephone services, and the revenue pool for funding that support is derived from in-state voice-only services. Broadband services are not supported nor are revenues from broadband included in the TUSF funding pool. Still, the total TUSF funding pool has shrunk for several reasons, including the redefinition of certain wireless services as broadband (not voice).

Figure 4 depicts that the nationwide base of voice telecommunications revenue against which the federal contribution factor was calculated has declined approximately 50 percent from 2010 through the first quarter of 2021. This contracting revenue pool, coupled with essentially flat obligations for high-

¹⁷ In 2000, the funding requirement for the federal High-Cost Fund was calculated to be \$1.1 billion compared with \$1.2 billion in the first quarter of 2021. The new and expanding federal universal service programs include support for schools and libraries, rural health care, and low-income customers.

cost universal service support (less than 1% CAGR), has resulted in the growth in the federal contribution factor to a level that now exceeds 30 percent, as shown above in Figure 3.

FIGURE 4: FEDERAL ESTIMATED SIZE OF THE TELECOM BASE



Source: Universal Service Administrative Company.

Noteworthy is the fact that the federal USF program continues to provide cost-based support to meet the required funding levels, consistent with the mandate of the Telecommunications Act, Section 254. A reasonable inference is that the FCC recognizes that the solution is not to underfund USF. Contrary to the path recently taken by the PUCT, the FCC has not sought to materially reduce the statutorily authorized level of high-cost USF support upon which a viable universal service program is dependent.

Noteworthy is the fact that the federal USF program continues to provide cost-based support sufficient to meet the calculated required funding levels, consistent with the mandate of the Telecommunications Act, Section 254.

Why is the TUSF necessary?

ALL TEXANS BENEFIT FROM A UNIVERSAL STATEWIDE NETWORK

Since its creation in 1987, TUSF has helped support a robust and well-maintained statewide telecommunications network for the benefit of all residents of the State. While the high-cost programs in TUSF support basic voice telephone services, the voice network also enables other advanced telecommunications services that have become essential for all Texas customers. Thus, the critical infrastructure investment in the statewide network supported by TUSF provides benefits to Texas customers that go beyond the universal availability of voice telephone service. However, since TUSF is specifically focused on voice-based services, this report concentrates on regulated voice services and on the mechanisms that assure compliance with the universal service policy of the Texas Legislature.

INVESTING IN AND OPERATING TELECOMMUNICATIONS NETWORKS

Installing and maintaining the Texas telecommunications network is expensive and the cost is uneven from one region to another, notably due to population density factors. In Texas, small and rural providers have spent over \$1 billion on infrastructure expansion and improvements in the last decade to provide communications services to 1.3 million households and 2,200 schools, colleges, government buildings, and other anchor institutions in territory covering over 148,000 square miles of the State.

HIGH COSTS IN RURAL MARKETS

This updated report will not restate all the data provided in the authors' 2016 Report, but the evidence from multiple sources is described in detail in that report from pages 35 to 45. In summary, the 2016 Report cites to three major studies compiled to quantify the economic realities of providing telecommunications services in rural and low-density regions. Two state studies were summarized, the first in 2007 related to Texas high-cost regions based on data from a total 350,000 lines, performed by the authors of both the 2016 Report and this update.¹⁸ A second state study was performed in 2011 by the Communications Division of the California Public Utilities Commission.¹⁹ The final study was a national

¹⁸ See Michael J. Balhoff, Robert C. Rowe, and Bradley P. Williams, *Universal Service Funding: Realities of Serving Telecom Customers in High-Cost Regions* (Balhoff & Rowe, LLC: Columbia, MD, 2007), available at <http://balhoffwilliams.com/pdf/USF%20Funding%20Realities%20of%20Serving%20Telecom%20Customers%20in%20High%20Cost%20Regions%207-9-07.pdf>. The data used in this study relied on forward-looking cost models similar to the HAI model that is mandated in Texas for the calculation of Universal Service payments. Texas mandated the use of the HAI forward-looking (economic) cost model for the largest carriers in the State to compute USF payments. The modeled cost and investment data used in this report were also forward-looking, with some of the inputs updated by the companies to reflect underlying and verifiable costs. Notably, the modeling was consistent across the entire data set. The model provided investment data that often do not match the embedded costs—due to the fact that the actually-incurred costs may have been incurred in an era when costs were higher or lower. Reconciling forward-looking to embedded costs is affected by other factors as well, including the timing of the investment and how much the assets have depreciated. The model also proposed operating costs, which were particularly helpful to this study since it is difficult and contentious to allocate overhead and other supra-wire-center operations to an individual switching center. While the model was not perfect, no other solution would match as well with Texas's HAI model. To the extent possible, every effort was made to be fair and precise in preparation of the original data and in summarizing the results. Still, it should be noted that the specific data points were different from one company to another and from one region to another. It is the conviction of the authors, however, that the data tell a valuable directional story for policymakers and clearly point to underlying systemic problems and challenges.

¹⁹ Communications Division of the California Public Utilities Commission, *Comparative Analysis of Small ILEC CHCF-A Carriers to Non-CHCF-A Carriers 2011*, December 2011, available at

inquiry, performed in 2000 by the Rural Task Force (“RTF”) which was created by Federal-State Joint Board on Universal Service.²⁰ That national study in 2000 provided the foundational analysis that led to key FCC reforms of universal service and intercarrier compensation (“ICC”) in 2001. The final part of that section of the 2016 Report cites economic studies concerning telecommunications in rural areas and the interdependence of rural and urban areas. The first is a study, entitled “Beyond Rural Walls: Identifying Impacts and Interdependencies among Rural and Urban Spaces,” published in October 2015 by Joshua Seidemann.²¹ The second includes articles published by the Federal Reserve Bank of Kansas City in its Economic Review.²²

In summary, the 2016 Report explains that the two state studies—Texas and California—and the RTF study provide confirmatory data. The high-level data are summarized below in [Table 2](#). The RTF and California studies indicate that average investment per line is about three times greater in rural markets compared with investment in urban areas, whether studied in 2000 or in 2011. Further, the Texas study provides information about rural Outside of Town Center data, indicating that the investment in these areas is, on average, approximately twice the level of investment inside the rural Town Center. However, these Texas data (Outside of Town Center versus Town Center) likely understate the relative investment statistics when comparing rural areas with urban areas, as the towns in the Texas study were all rural and more expensive to serve compared with denser truly urban areas. The RTF and California studies indicate that the operating costs incurred to provide service in more rural regions are about twice the operating costs in urban areas. Finally, the statistics about household density for the national RTF study indicate that rural areas have about one-tenth the density of urban areas. The Texas study compares density for rural Outside of Town areas with the density inside of rural towns, finding the

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<https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&cad=rja&uact=8&ved=0ahUKEwj4iZ2l0aHJAhXC5yYKHdWfDM0QFggdMAA&url=http%3A%2F%2Fwww.epuc.ca.gov%2FNFR%2Frdonlyres%2F48FA1720-99CA-4124-A118-E8D5BA55D812%2F0%2FComparativeAnalysisofSmallLECCHCFACarrierstoNonCHCFACarriers2011.pdf&usq=AFQjCNGsJscJOsRdc4CZdKEqdLjms8NfGg&bvm=bv.108194040.d.eWE> (CPUC 2011 Study).

²⁰ The Rural Task Force was created by the Joint Board on Universal Service to study potential reforms; its appointed membership included a wide range of industry interests and experts: Chairman William R. Gillis, Commissioner, Washington Utilities and Transportation Commission; Robert Schoonmaker, Vice President, GVNW Consulting, Inc.; Thomas Beard, President, National Phone Company; Carol Ann Bischoff, Executive Vice President and General Counsel, Competitive Telecommunications Association; Jack Brown, Management Consultant Golden West Telecommunications Cooperative, Inc.; David R. Conn, Vice President Law and Regulatory Affairs, McLeod USA, Inc.; Gene DeJordy, Executive Director: Regulatory Affairs, Western Wireless Corp.; Billy Jack Gregg, Director, West Virginia Consumer Advocate Division; Joel Lubin, Regulatory VP-Law and Public Policy, AT&T; Joan Mandeville, Assistant Manager, Blackfoot Telephone Company; Christopher McLean, Deputy Administrator, Rural Utilities Service, USDA; Gwen Moore, President, GEM Communications; Jack Rhyner, President and CEO, TelAlaska; Jack Rose; David Sharp, President and CEO, Virgin Islands Telephone Corp.; Stephen G. Ward, Public Advocate, State of Maine Public Advocate Office. The RTF relied upon the professional support services of the National Exchange Carrier Association; The National Telecommunications and Information Administration--U.S. Department of Commerce; The Rural Utility Service--U.S. Department of Agriculture and The Rural Policy Research Institute and the University of Missouri Office of Social and Economic Data Analysis.

²¹ Joshua Seidemann, “Beyond Rural Walls: Identifying Impacts and Interdependencies Among Rural and Urban Spaces,” NTCA, October 2015, (Seidemann) available at [Beyond Rural Walls](#).

²² Mark Drabenstott and Katharine H. Sheaff, “The New Power of Regions: A Policy Focus for Rural America—A Conference Summary,” Economic Review, Second Quarter 2002, Federal Reserve Bank of Kansas City, pp. 2-3.

Outside of Town areas to have only 25 percent of the density found in rural towns. Again, the Texas study, in comparing relative densities within rural areas, understates the density differences that are found when comparing these rural areas (outside and inside rural towns) with truly urban areas.

TABLE 2: TEXAS, CALIFORNIA AND RTF STUDIES—INVESTMENT/OPERATING COSTS/DENSITY

	2000 RTF Study	2007 Texas Study*	2011 California Study
Rural investment v. urban (per line)	333% (\$10k v. \$3k)	205%	333%
Rural operating costs v. urban (per line)	186% (\$190 v. \$80)	NA	207%
Rural household density v. urban	12% (13 v. 105)	25%	NA

*Comparisons based on Balhoff & Williams 2007 Study, Town Center with Outside Town.

Source: RTF White Paper 2; Balhoff & Williams, LLC; California Public Utilities Commission.

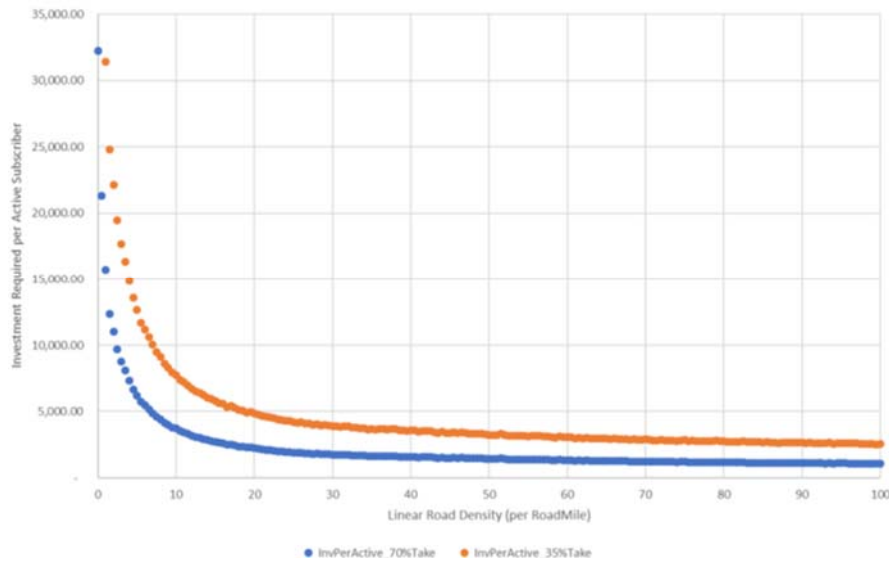
Since the authors’ last report, a consulting firm that has supported multiple FCC analyses, CostQuest Associates (“CQA”), prepared a 2018 study in which CQA studied broadband investment costs across the U.S. to understand how density affected per household costs. Notably, broadband network investment costs are virtually the same as would be expected in provisioning a voice-network, and those costs are arguably more cost effective than the costs for a new “copper” network. The CQA study notes that “[a]s one moves to more rural areas, with any network, the costs per user become increasingly high, eventually leading to unsustainable business models to provide network services.”²³ Figure 5 from the CQA report provides an important insight regarding the economics of deploying networks and delivering broadband services in low-density areas. The figure depicts the average investment requirements to provide fiber-based broadband service per active (i.e., subscribing) household based on the population density of the Census Block Group in which the household is located. The blue dots in the figure assume that 70% of the homes passed subscribe to service, so the “line” represents investment cost per household (on the Y-axis) given the density of the census block (on the X-axis).²⁴ CQA also graphed with orange dots the escalation in investment cost that occurs assuming that the “take-rate” is cut in half to 35%, as the analysis was also focused on potential broadband penetration rates. For example, if 35% of the households subscribe to the broadband service, the investment cost per subscriber is approximately \$5,000 in areas where the “linear road density” is 20 households per road mile. The report warns about the challenges where density is 20 households per road mile, noting “[t]here are vast regions of the U.S. with linear density below that level.” The graph demonstrates that as density increases (moving to the right on the graphic), the investment cost per subscribing household falls, and conversely as market density decreases (moving to the left on the graphic), the costs escalate rapidly in a hockey stick effect to above \$30,000 per active household. In addition, CQA’s cost model found that in comparing suburban and rural areas the capital cost per customer location for conduit and poles is approximately 5.6 times higher in rural areas, while the capital investment for fiber optic cable is approximately 4.2 times higher in rural areas.²⁵

²³ Steve G. Parsons and James Stegeman, Rural Broadband Economics: A Review of Rural Subsidies, available at <https://www.costquest.com/uploads/pdf/ruralbroadbandeconomics-areviewofruralsubsidiesfinalv07112018r2.pdf>, (hereafter “Parsons/Stegeman”), at 5.

²⁴ *Id.* at 22. In 2010, the consulting company, VantagePoint Solutions, prepared a 2010 report that was attached as Appendix A in an FCC filing (available at <https://ecfsapi.fcc.gov/file/7020522078.pdf>), analyzing 4 exchanges operated by a Nebraska carrier, Great Plains Communications; the report notes the problems with high investment costs but adds that the operating costs for middle mile are very high in rural areas (*see, e.g.*, Appx. A, at 8.)

²⁵ Parsons/Stegeman, at 20.

FIGURE 5: COSTQUEST 2018 STUDY OF INVESTMENT PER SUBSCRIBER



Source: CostQuest Associates.

SERIOUS RISKS IN BELOW-MARKET RETURNS ON INVESTMENT

An important support-related issue should be highlighted. TUSF is today falling well short, as conceded by the PUCT, in providing the support sufficient to generate legislatively-approved rates of return on regulated operations for the small rate-of-return carriers and presumably for mid-sized carriers. But even before 2021, the annual reports to the PUCT filed in 2020, as reviewed by PUCT staff, verify that the majority of carriers are earning less than the designated rate band, as will be detailed below. The rate of return data raise a major concern as 2021 TUSF payments are cut by a meaningful amount, such as 70 percent, with the result that recent underfunding will become more extreme and most carriers will generate rates of return on regulated operations that fall well below the legislated rate band.

If the TUSF is insufficiently funded, the conclusion based on those data is that, at best, there will be no economic incentive or rationale for these carriers to continue to invest in uneconomic, high-cost areas. Requiring them to do so while providing insufficient TUSF support to generate economic returns on investment would result in an unfunded regulatory mandate. In a worst-case scenario, the carriers will have difficulty remaining viable going forward. In either scenario, underfunding TUSF will have serious negative impacts on customers in high-cost regions.

Some parties may argue that rural carriers do not need returns on capital that reach 6.75 percent, but, in the authors’ view, this rate falls well below the financial industry’s expected *equity* returns for companies such as these and also

If the TUSF is insufficiently funded, the conclusion . . . is that, at best, there will be no economic incentive or rationale for these carriers to continue to invest in uneconomic, high-cost areas. At worst, these carriers will have difficulty remaining viable going forward, with serious negative impacts on customers in high-cost regions.

below the standards typically required in utility regulation.²⁶ To illustrate this using one example, as of February 2021, Duff & Phelps, the most prominent source of cost of capital data, recommended use of a normalized risk-free rate of 2.50 percent to which an investor, applying the commonly-used Capital Asset Pricing Model (“CAPM”), would add a *market equity* premium of 5.50 percent that would total an expected overall market equity return of 8.0 percent *before* adjusting for industry-specific risk or any size-related risk premia for very small companies.²⁷ Adjusting the CAPM equity return calculation for the greater risk associated with small companies (using Duff & Phelps’ tenth decile, which is not the largest premium that can be used) would add 4.99 percent to the 8.0 percent market return, which would then be

²⁶ The Supreme Court of the United States has confirmed well-established legal precedents for defining the allowed fair rate of return in ratemaking proceedings. In *Bluefield Water Works & Improvement Co. v. Public Service Commission of West Virginia*, 262 U.S. 679 (1923) (“*Bluefield*”), the Supreme Court concluded that:

A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the general part of the country on investments in other business undertakings which are attended by the corresponding risks and uncertainties. . . . The return should be reasonable, sufficient to assure confidence in the financial soundness of the utility, and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise money necessary for the proper discharge of its public duties.

In *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 391 (1944) (“*Hope*”), which expanded on *Bluefield* and emphasized that a utility’s revenues must also cover “capital costs,” the Supreme Court further found that:

From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. . . . By that standard *the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks*. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and attract capital. (Emphasis added.)

In *Duquesne Light Company et al. v. David M. Barasch et al.*, 488 U.S. 299 (1989), the Supreme Court reiterated the standard of *Hope* and *Bluefield* and then added important new guidelines, including “regulatory risk,” which is a distinct risk to be recognized by regulators in defining a fair rate of return:

Admittedly, the impact of certain rates can only be evaluated in the context of the system under which they are imposed. One of the elements always relevant to setting the rate under *Hope* is the return investors expect given the risk of the enterprise. *Id.*, at 603, 64 S.Ct., at 288 (“[R]eturn to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks”); *Bluefield Water Works & Improvement Co. v. Public Service Comm’n of West Virginia*, 262 U.S. 679, 692-693, 43 S.Ct. 675, 679, 67 L.Ed. 1176 (1923) (“A public utility is entitled to such rates as will permit it to earn a return . . . equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties”). The risks a utility faces are in large part defined by the rate methodology Consequently, a State’s decision to arbitrarily switch back and forth between methodologies in a way which required investors to bear the risk of bad investments at some times while denying them the benefit of good investments at others would raise serious constitutional questions.

²⁷ Duff & Phelps, 2020 Cost of Capital, available as a subscription service. If a carrier has meaningful debt, the cost of equity and the cost of debt are proportionately combined to generate an expected weighted average cost of capital. However, across the United States, a very significant number of small rural telecommunications carriers have relatively limited levels of debt.

adjusted by a multiplier of 1.06 for telecommunications industry-specific risk and the total expected equity rate of return for the small Texas carriers would be 13.32 percent—above the upper end of the Texas Legislature’s rate of return band set in 2017.²⁸

The authors do not have access to all the small Texas carrier balance sheets but believe that many of the carriers’ cost of capital would be close to the 13 percent expected equity rate of return as calculated above. However, if one assumes that a carrier has debt that is 30 percent of its capitalization and the interest rate on the debt is 3.0 percent, then the calculation of the weighted average cost of capital (“WACC”) results in a required return of 10.22 percent.²⁹ All but 8 of the 43 SB 586 Reporting Carriers reported 2019 rates of return below this 10.22 percent return level, the level that reflects a market-based expected rate of return on capital.

All but eight of the 43 SB 586 small Texas carriers reported 2019 rates of return below the level that reflects a market-based expected rate of return on capital.

If a carrier is earning less than a market rate of return on its investment for any extended period, the risk is that capital will flow to other investments in telecommunications or other industries. Depressed access to capital will have the predictable result of significant damage to a capital-intensive business such as local exchange carrier operations. In addition, insufficient returns on capital will almost certainly lead to a change in the carrier’s ability to serve many of its customers or lead to enterprise-wide financial failure.

Depressed access to capital will have the predictable result of significant damage to a capital-intensive business such as local exchange carrier operations.

The authors believe that a related insight is important. Inadequate maintenance or cessation of capital-intensive operations, such as telecommunications, cannot be reversed easily because the amount of new capital investment required to restore operations is likely to be outsized when compared to the costs associated with ongoing operations. Accordingly, if the policy for statewide telecommunications service in Texas is to remain effective and sustainable for the long-term, capital costs must be covered consistently, predictably, and at market-based financial rates of return.

BUILDING AND OPERATING A NETWORK IN SPARSELY POPULATED AREAS

Affordable telephone rates cannot cover the costs of building and operating a network to provide phone service in sparsely populated areas, so TUSF support remains critical to keeping all Texans connected. Two of the TUSF programs—the “high-cost programs”—support and offset the costs of service in lower-density rural areas. Again, the “high-cost programs” are the THCUSP and the SRILEC USP.

²⁸ The calculation, based on February 2021 available from Duff & Phelps Cost of Capital is the following:

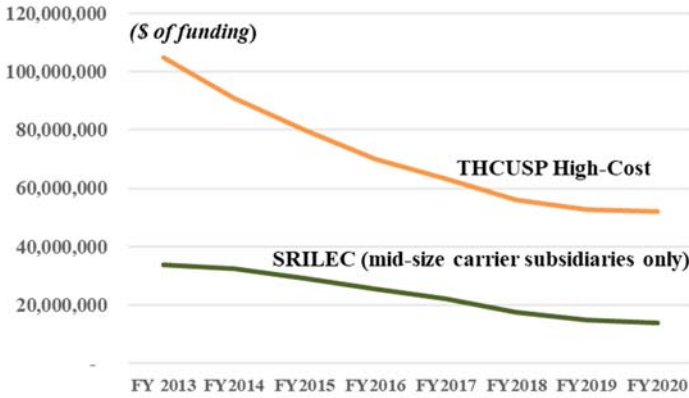
Duff&Phelps risk-free rate	Beta adjusted (1.06x) equity D&P mkt return of 5.5%	Size premium (4.99%)	Expected equity return (sum of prior 3 columns)
2.50%	5.83%	4.99%	13.32%

²⁹ The following is illustrative, as the authors do not have access to capitalization data of the small Texas carriers.

Illustrative capitalization	% of capitalization	Cost of capital	WACC
Debt	30%	3.00%	0.90%
Equity	70%	13.32%	9.32%
Total			10.22%

Figure 6 provides a historical graphic depicting 2013 to 2020 support to carriers other than the SB 586 Reporting Carriers, including larger carriers that own subsidiary companies that qualify for SRILEC support. The perspective highlights the reduced support payments over the years.

FIGURE 6: TUSF SUPPORT FOR CARRIERS WITH SERVICE TO MORE THAN 31,000 LINES, 2013 TO 2020



Source: Solix reports.

Table 3 provides a carrier-by-carrier summary of THCUSP program support in 2020. As explained above, this support is contracting, and has contracted by 17.6 percent since 2017.

TABLE 3: TEXAS HIGH-COST UNIVERSAL SERVICE PROGRAM SUPPORT IN 2020

LEC/ETP	2020 THCUSP	% of total
AMA Communications dbaAMA TechTel Comm	\$ 18,177,083.56	21.0%
Central Telephone Co. of Texas, Inc.	4,995,587.88	5.8%
CGKC&H RCLP dba West Central Wireless	1,382,988.10	1.6%
Cumby Telephone Cooperative-CLEC	1,349,271.13	1.6%
DialTone Services, LP	5,542,228.80	6.4%
ETS Telephone dba En-Touch Systems	105,743.13	0.1%
Evolve Cellular Inc. dba Evolve Broadband	51,103.46	0.1%
GCEC Technologies	13,614.48	0.0%
Guadalupe Valley Comms Systems, L.P.	42,774.42	0.0%
Mid-Tex Cellular Limited	195,476.07	0.2%
Panhandle Telecommunication Systems, Inc	493,890.32	0.6%
Santa Rosa Telephone Cooperative - CLEC	2,584,380.60	3.0%
Texas RSA 15B2 Limited Partnership	173,527.58	0.2%
United Telephone Co of Texas	9,284,950.37	10.7%
Valor Telecom of TX, dba Windstream SW	37,845,861.47	43.8%
VTX Telecom, LLC	1,447,218.37	1.7%
West Central Wireless (C T Cube, LLC)	1,855,724.90	2.1%
WT Services, Inc.	16,074.00	0.0%
XIT Telecommunications & Technology Inc.	837,791.44	1.0%
Total	\$86,395,290.08	100.0%

Source: Solix reports.

Table 4 presents data related to the SB 586 Reporting Carriers that have filed legislatively-mandated annual reports with the PUCT in 2020. Because access-line data were not available for 2020, the table lists 2019 lines. Using 2019 access line data, the 43 SB 586 Reporting Carriers in the table served a per square mile average and median number of lines of approximately 4.9 and 2.0, respectively. The number of voice access lines per square mile is likely similar or lower in 2020. The data in the table

highlight the points made earlier that carrier returns on investment were, on average, very low in 2020, and any reduction in support will make the returns more distressed.

More telling, the table reports that the PUCT staff reviewed the SRILEC filings and found 32 of the 43 SB 586 Reporting Carriers are earning a regulated rate of return below 6.75 percent (i.e., Category 1), below the lower threshold of the Legislature’s rate band. Only two carriers are earning returns higher than the upper bound of the Legislature’s rate band, with one of those carriers close to the upper threshold of the band. More ominous, 12—or 37.5 percent—of the 32 underearning carriers have negative rates of return on regulated revenues with an average return of -8.24 percent. And those carriers with negative returns accounted for 28 percent of the SB 586 Reporting Carriers.

... 32 of the 43 SB 586 Reporting Carriers are earning a regulated rate of return below 6.75 percent ... and 12 of the 32 underearning carriers have negative rates of return on regulated revenues.

TABLE 4: TEXAS SMALL CARRIER 2019 ACCESS LINES AND 2020 REPORTED RATE OF RETURN

Company Name	Docket	Number of Texas 2019 Access Lines	Square Miles in Service Region	2019 Access Lines/Sq Mile	2020 Reported ROR	Staff's Recommendation
Above the rate band						
1 Cameron Communications	<u>51321</u>	364	173	2.1	135.70%	N/A
2 Brazoria Telephone Company	<u>51336</u>	1,766	290	6.1	12.90%	Cat. 3
Within the rate band						
1 Alenco Communications, Inc.	<u>51302</u>	1,397	4,000	0.3	11.71%	Cat. 2
2 XIT Rural Telephone Cooperative, Inc.	<u>51295</u>	1,052	3,323	0.3	11.18%	Cat. 2
3 West Plains Telecommunications, Inc.	<u>51297</u>	2,816	400	7.0	10.75%	Cat. 2
4 Valley Telephone Cooperative, Inc.	<u>51330</u>	4,424	7,500	0.6	10.64%	N/A
5 Muenster Telephone d/b/a Nortex Communications	<u>51315</u>	3,055	478	6.4	10.29%	Cat. 2
6 ENMR Telephone Cooperative, Inc.	<u>51298</u>	329	99	3.3	10.24%	Confidential
7 Big Bend Telephone Company, Inc.	<u>51331</u>	4,260	17,593	0.2	10.00%	Cat. 2
8 Lake Livingston Telephone Company	<u>51308</u>	540	18	30.0	9.98%	Cat. 2
9 Southwest Texas Telephone Company	<u>51332</u>	3,096	2,691	1.2	7.56%	N/A
Below the rate band						
1 Central Texas Telephone Cooperative, Inc.	<u>51327</u>	5,158	3,400	1.5	6.61%	Cat. 1
2 Coleman County Telephone Cooperative, Inc.	<u>51307</u>	1,521	280	5.4	5.82%	Cat. 1
3 Brazos Telephone Cooperative, Inc.	<u>51300</u>	2,526	1,508	1.7	5.74%	Cat. 1
4 West Texas Rural Telephone Cooperative, Inc.	<u>51333</u>	1,396	2,838	0.5	5.37%	
5 Santa Rosa Telephone Cooperative, Inc.	<u>51346</u>	1,331	2,200	0.6	5.01%	Cat. 1
6 Border to Border Communications, Inc.	<u>51314</u>	59	786	0.1	4.76%	Cat. 1
7 La Ward Telephone Exchange, Inc.	<u>51309</u>	680	235	2.9	4.65%	Cat. 1
8 Community Telephone Company	<u>51318</u>	1,290	662	1.9	4.46%	Cat. 1
9 Five Area Telephone Cooperative, Inc.	<u>51296</u>	754	1,900	0.4	3.81%	Cat. 1
10 Poka Lambro Telephone Cooperative, Inc.	<u>51325</u>	1,939	4,500	0.4	3.46%	Cat. 1
11 Riviera Telephone Company, Inc.	<u>51328</u>	989	1,000	1.0	3.35%	Cat. 1
12 Ganado Telephone Company d/b/a YK Communications	<u>51306</u>	1,401	320	4.4	3.20%	Cat. 1
13 Tatum Telephone Company	<u>51313</u>	499	98	5.1	2.45%	Cat. 1
14 Industry Telephone Company	<u>51324</u>	1,816	230	7.9	2.16%	Cat. 1
15 Electra Telephone Company	<u>51312</u>	518	191	2.7	1.95%	Cat. 1
16 Colorado Valley Telephone Cooperative, Inc.	<u>51322</u>	5,118	898	5.7	1.63%	Cat. 1
17 Livingston Telephone Company	<u>51344</u>	4,306	83	51.9	1.27%	Cat. 1
18 Cap Rock Telephone Cooperative, Inc.	<u>51299</u>	3,400	5,000	0.7	0.96%	Cat. 1
19 Mid-Plains Rural Telephone Cooperative, Inc.	<u>51323</u>	2,632	3,769	0.7	0.44%	Cat. 1
20 Eastex Telephone Cooperative, Inc.	<u>51278</u>	17,346	2,314	7.5	0.01%	Cat. 1
21 South Plains Telephone Cooperative, Inc.	<u>51293</u>	3,588	2,335	1.5	-0.53%	Cat. 1
22 Blossom Telephone Company	<u>51329</u>	592	100	5.9	-0.93%	Cat. 1
23 Etex Telephone Cooperative, Inc.	<u>51291</u>	10,073	710	14.2	-1.03%	Cat. 1
24 Lipan Telephone Company	<u>51292</u>	1,139	262	4.3	-1.71%	Cat. 1
25 Wes-Tex Telephone Cooperative, Inc.	<u>51294</u>	2,157	3,172	0.7	-2.28%	Cat. 1
26 Hill Country Telephone Cooperative, Inc.	<u>51319</u>	11,781	3,500	3.4	-2.76%	Cat. 1
27 Taylor Telephone Cooperative, Inc.	<u>51335</u>	3,817	2,000	1.9	-3.81%	Cat. 1
28 Dell Telephone Cooperative, Inc.	<u>51305</u>	668	8,000	0.1	-5.63%	Cat. 1
29 Cumby Telephone Cooperative, Inc.	<u>51326</u>	683	75	9.1	-12.84%	Cat. 1
30 North Texas Telephone Company	<u>51317</u>	245	115	2.1	-16.34%	Cat. 1
31 Totelcom Communications, LLC	<u>51320</u>	2,329	1,300	1.8	-16.75%	Cat. 1
32 Peoples Telephone Cooperative, Inc.	<u>51316</u>	7,472	852	8.8	-34.23%	Cat. 1
Average		2,845		4.9	4.87%	
Median		1,766		2.0	3.35%	

Source: PUCT data and Solix reports; Categories 1, 2 and 3 refer to carrier returns below, within and above the SB 586 rate band, respectively.

Federal and state USF support levels are monitored carefully and are audited. At best, without sufficient TUSF, carriers will reduce operations in the most-costly service regions. Financial failure of high-cost

carriers is also possible, as core telephony and related support revenue is often a significant percentage of total operating cash flows. Underfunding TUSF puts customers across large regions of Texas at risk of losing not only wireline voice telephone service, but also wireless communications services that depend on the underlying wireline network. Any protracted underinvestment in the high fixed-cost telecommunications network—particularly in rural, high-cost areas—is likely to be difficult to cost-effectively reverse.

Underfunding TUSF puts customers across large regions at risk to lose wireline and wireless services that depend on the underlying wireline network. Any protracted underinvestment of the high fixed-cost network is likely to be difficult to cost-effectively reverse.

Summary Legislative History of the TUSF

The authors' 2016 Report focused from pages 17 to 32 on a comprehensive review of Texas universal service policy and the legislative history of TUSF. This report considers more recent developments regarding TUSF after a brief historical summary.

In 2011, Texas House Bill 2603 froze the TUSF small company support at levels set in Docket No. 18516, allowing for an annual adjustment based on the Consumer Price Index (“CPI”). In 2012, AT&T and Verizon Communications Inc. (now Frontier) elected to opt out of TUSF by January 1, 2017, pursuant to Project No. 39939. In 2013, SB 583 reduced disbursements for Texas carriers that provided service to more than 31,000 access lines, unless those carriers demonstrated a financial need. CenturyLink, Windstream, Consolidated Communications and Guadalupe Valley subsequently demonstrated that their costs in certain regions justified inclusion in the TUSF.

In addition, as part of the TUSF, competitive local exchange carriers (“CLECs”) and wireless service providers that were eligible telecommunications providers (“ETPs”) were to receive support that was tied to the level of support provided to the ILEC serving in the region where the CLEC/ETP was also serving customers.

SENATE BILL 583, SB 586, 16 TAC §§ 26.403 AND 26.405

SB 583 provided extended CPI adjustment for ILECs with less than 31,000 access lines until September 1, 2017 but specified that TUSF would be reduced at that point if the Texas Legislature did not act to update TUSF. The resultant new legislation was SB 586, adopted in 2017 to resolve the SB 583 funding “cliff.”

During its 2017 session, the Texas Legislature passed SB 586 to providing Texas small and rural local telephone companies—and their customers—with a long-term, regulatory-efficient mechanism intended to assure a reasonable rate of return for service in high-cost regions of the State. SB 586 established that Texas' small telecommunications companies would receive financial support that would offset costs that were relatively higher than those in urban areas, with the goal of assuring maintenance and upgrades of critical infrastructure composing rural networks.

SB 586 straddled the FCC’s targeted 9.75 percent allowed rate of return, legislating that a reasonable return was 6.75 percent to 11.75 percent, or 300 basis points below the FCC target rate to 200 basis points above it. The rate of return applies only to telecommunications companies and cooperatives with less than 31,000 access lines, provided that the carrier elects to participate in the process defined in SB 586. The PUCT was required to initiate a rulemaking by January 1, 2018 to establish procedures for comprehensive annual financial reports and TUSF support adjustments for those carriers that realized returns outside of the legislatively-defined reasonable rate band.

SB 586 straddled the FCC’s targeted 9.75 percent allowed rate of return, legislating that a reasonable return was 6.75 percent to 11.75 percent, or 300 basis points below the FCC target rate to 200 basis points above it.

The above discussion regarding SB 586 / 16 TAC §§ 26.407 applies only to providers with fewer than 31,000 access lines. Meanwhile, SB 583 (2013) and 16 TAC § 26.403 and § 26.404 spell out the substantive rules related to mid-sized carriers with more 31,000 lines, as well as the TUSF rules for designated ETPs approved by the PUCT pursuant to §26.417. 16 TAC § 26.405 provides further rules applicable to financial support mechanisms and processes related to State THCUSP and SRILEC mid-sized carriers, defining determination of “need,” the criteria for setting the funding levels, proceedings related to need and support levels, and deaveraging support for ILEC ETPs from the SRILEC USP.

POWERS OF THE PUCT TO MANAGE TUSF

To develop the rules related to SB 586, the PUCT opened Project No. 47669 in October 2017. As a result, in addition to the rules cited above, the PUCT adopted new § 26.407 that created a new detailed financial reporting obligation and defined certain SRILEC Universal Service Plan Support adjustments. The addition of rule § 26.407 established criteria by which a small ILEC may request the PUCT to adjust the amount of SRILEC support the carrier will receive, such that the support is sufficient to ensure that the carrier earns a reasonable rate of return under the rule, as required by SB 586. The PUCT’s criteria as proposed on May 25, 2018 include the following:

The addition of rule § 26.407 established criteria by which a small ILEC may request the PUCT to adjust the amount of SRILEC support the carrier will receive, such that the support is sufficient to ensure that the carrier earns a reasonable rate of return under the rule, as required by SB 586.

- An annual report of a requesting small ILEC
 - A. The small ILEC that submits a written notice . . . must file an annual report each year with the commission, using commission-prescribed forms that are available on the commission’s website. . . . Subsequent annual reports must be filed no later than May 15th of each year.
 - B. The annual report filed by a small ILEC must include information on the following:
 - 1) Summary of revenues and expenses;
 - 2) Detail for all revenue, expense, and capital accounts;
 - 3) Invested capital;
 - 4) Intrastate federal income taxes calculated at the applicable tax rate;
 - 5) Network access service revenue;
 - 6) Weighted average cost of capital;
 - 7) Historical financial statistics;
 - 8) Proposed company adjustments;
 - 9) The name, job title, and total annual compensation of each officer, director, and, for investor-owned companies, owners and former owners;

- 10) 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;
 - 11) All detail and supporting documentation necessary to support each of the items in subsection (e)(2); and
 - 12) An authorized official's signature.
- C. The small ILEC must also provide its full and complete cost allocation manual, which is documentation required in the Code of Federal Regulations (“CFR”).³⁰
- Annual reports will be reviewed by PUCT 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. The review of each ILEC shall be assigned a category rating depending on the ILEC’s rate of return.
 - A. Category 1 – If the rate of return is *below* the rate band, a small ILEC may file an application for an increase in TUSF to allow the small ILEC to earn an amount that would be considered a reasonable rate of return, except that the adjustment may not be more than 140 percent of the annualized support the provider received in the 12-month period before the date of the adjustment. In addition, any rate adjustments may not adversely affect universal service.
 - B. Category 2 – If the rate of return is *within* the rate band (6.75 percent to 11.75 percent), the small ILEC will be considered to be earning a reasonable rate of return and will not be eligible to file for TUSF adjustment. The PUCT “may not initiate a proceeding against a small ILEC that has a reported or commission-staff adjusted rate of return [within the rate band].”
 - C. Category 3 – If the rate of return is *above* the rate band, PUCT staff “may initiate a proceeding to review and adjust the small ILEC's . . . support or basic rates to adjust the small ILEC's rate of return into the reasonable rate of return range.”

As a result of the new rules, the SRILEC carriers in 2020 filed more than 80,000 pages of information and data related to TUSF, complying with the requirements to provide annual reports, responding to PUCT staff’s Requests for Information (“RFIs”), and providing other supporting documentation.

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AUTHORS’ REVIEW OF TEXAS CARRIER FILINGS

The authors have reviewed an extensive sampling of the 80,000 pages of filings submitted in 2020 by the SB 586 Reporting Carriers. To be clear, the documentation provided by the carriers includes data and

³⁰ 47 CFR § 64.903. The requirement is that the manual include: (1) a description of each of the carrier's nonregulated activities; (2) a list of all the activities to which the carrier now accords incidental accounting treatment and the justification therefor; (3) a chart showing all of the carrier's corporate affiliates; (4) a statement identifying each affiliate that engages in or will engage in transactions with the carrier and describing the nature, terms and frequency of each transaction; (5) a cost apportionment table showing, for each account containing costs incurred in providing regulated services, the cost pools with that account, the procedures used to place costs into each cost pool, and the method used to apportion the costs within each cost pool between regulated and nonregulated activities; and (6) a description of the time reporting procedures that the carrier uses, including the methods or studies designed to measure and allocate non-productive time.

forms prepared by experienced third-party cost consultants and the presentations are in many instances similar in form from one carrier to the next. In addition, the PUCT RFIs are based on a template, but are slightly modified in light of whether the carrier is a CLEC/ETP or an ILEC or a privately-owned company or a cooperative. The Cost Allocation Manuals (“CAMs”) are required as part of the CFR and can be assumed to be in compliance as they are subject to federal regulatory oversight. The authors found no evidence that PUCT staff challenged the data provided or the approach taken in any carrier CAM.

Based on the extraordinary detail in the annual filings provided by the carriers, the review of the PUCT staff, the preparation of materials by respected industry specialists, and the authors’ analysis, the evidence is that the carrier submissions are reasonable, substantially accurate, and sound indications that, at a minimum, the level of TUSF assigned to the carriers is justified. As a result, a unilateral reduction in TUSF high-cost support below the level the PUCT concedes is required to fund TUSF appears contrary to the intent of the Texas Legislature and is inconsistent with the substantial detail supporting the need for ongoing TUSF support reflected in the filings submitted by the carriers to the PUCT in 2020.

Based on the extraordinary detail in the annual filings provided by the carriers, the review of the PUCT staff, the preparation of materials by respected industry specialists, and the authors’ analysis, the evidence is that the carrier submissions are reasonable, substantially accurate, and sound indications that, at a minimum, the level of TUSF assigned to the carriers is justified.

FILING REQUIREMENTS IN OTHER STATES

The authors analyzed the other major state universal service programs to compare the rigor of the Texas requirements and review processes. This report does not attempt to update the profile of the other state programs cited in the 2016 Report, but the authors have researched the filings required by those states to assess whether they might require more detailed and informative oversight compared with the Texas rules. The summary is that the other states with significant universal service funds require annual reports but do not require the same level of broad and detailed data and supporting documentation such as that required by the PUCT. It appears that the PUCT is able to monitor and assess the Texas carriers on the basis of detailed data that is exceptional, compared with the states surveyed here.

The PUCT is able to monitor and assess the Texas carriers on the basis of detailed data that is exceptional, compared with the states surveyed here.

California’s High Cost Fund (“CHFC”) is the second largest U.S. state universal service fund, providing support to carriers through an “A” Fund for ten small carriers and a “B” Fund for the three largest ILECs in the state. The California Public Utilities Commission (“CPUC”) Code § 275.6 requires the CPUC, in administering the CHCF-A, to promote customer access to advanced services in rural areas. The CPUC focuses on small company returns using all reasonable investments necessary to provide voice services and to deploy broadband-capable facilities. Public Utilities Code § 739.3 requires the CPUC to establish and maintain the CHCF-B to provide support to large providers that are Carriers of Last Resort (“COLR”) for provision of basic telecommunication service in the high-cost portions of their service areas. Carriers are required to file annual reports that include selected financial data, operational and financial information reports, and calendar year affiliate transaction reports, as well as certain FCC filings. Carriers can be required to appear for rate cases.

Louisiana requires contributions from the state’s Telecommunications Service Providers (“TSPs”) into a fixed fund of approximately \$45 million which is allocated to recipient carriers designated as COLRs. There are ten small independent ILECs with COLR duties. The underlying basis for the fund is currently the rural ILECs’ loop costs as submitted to the National

Exchange Carrier Association and the federal Universal Service Administrative Company. The Louisiana Public Service Commission evaluates the state fund every three years. Carriers file reports semiannually to disclose financial data related to interstate, intrastate, and non-regulated services, pursuant to General Order No. R-31839, section 701(J). Reports are to include annual reports of the ILEC and parent corporation and, if applicable, SEC Forms 10Q and 10K of the ILEC and parent corporation, proxy statements containing financial data not in annual reports, and shareholder newsletters.

The **Colorado** High-Cost Support Mechanism (“HCSM”) requires reports that are defined in the Code of Colorado Regulations. Rule 723-41-10.11 mandates quarterly reports of each Eligible Provider to reconcile receipts and support payments, consistent with Rule 723-41-7.4.3 and 9.7. According to Rule 723-41-10.12, the carriers may be required to provide supplemental and forecast information requested by the third-party HCSM Administrator. Rule 723-41-10.14 provides that the Fund and the HCSM records covering both collections and disbursements shall be audited periodically by an independent external auditor at the discretion of the Colorado Public Utilities Commission.

Kansas provides universal service support through the Kansas Universal Service Fund (“KUSF”), which in 2020 was based on a contribution factor of 9.40 percent and in 2021 rises to 10.84 percent.³¹ In a study by a Kansas taskforce in 2019, the then-current rate of 6.88 percent was found to be comparable to those of at least four other states—Nebraska, New Mexico, Oklahoma and Oregon.³² Kansas Statute § 66-2008 requires that the carriers shall provide annual reports—including balance sheet data, investments, income statement, KUSF data by quarter, boards of directors, and ownership—and the Kansas Corporation Commission can periodically review the KUSF to determine if the costs of qualified telecommunications public utilities, telecommunications carriers and wireless telecommunications service providers justify modification of the KUSF. For each ILEC operating under traditional rate of return regulation, all KUSF support, including any adjustment, is based on the carrier's embedded costs, revenue requirements, investments and expense.

Nebraska has a surcharge to support the Nebraska Universal Service Fund (“NUSF”). As of April 1, 2019, intrastate NUSF contributions from residential telecommunications services are assessed on a per-connection basis, while business telecommunications services continue to be assessed based on revenue. 291 Neb. Admin. Code, Ch. 5, § 002.24C-F requires that each local exchange carrier must file an annual report with the Commission, including its annual report to the FCC. Exchange carriers that do not file an annual report with the

The authors’ review of other states and the Texas TUSF rules supports the conclusion that Texas’ regulatory framework since 2017 provides a robust system for monitoring and review of TUSF support payments, and the carrier reporting in Texas is more detailed than that provided in other states with major state USF programs.

³¹ Kansas Corporation Commission, “Kansas Universal Service Fund (‘KUSF’), March 2020 – February 2022,” available at <https://kcc.ks.gov/images/PDFs/telecommunications/kusfhistory.pdf>, p. 1.

³² Sandy Reams, “Overview of the Kansas Universal Service Fund,” Statewide Broadband Task Force, Subcommittee 3, July 17, 2019, available at https://kcc.ks.gov/images/PDFs/presentations-and-legislative-testimony/Presentation_KUSF_071719.pdf, slide 5: “Nebraska - 6.95% for business, residential \$1.75 per connection; New Mexico - \$1.24 per residential & business connection; Oklahoma – 6.28% of total intrastate retail revenue (7/1/2019); Oregon - 8.50% of gross retail revenue.”

FCC are to file an annual report on a form prescribed by the Commission.

In summary, the authors' review of other states and the Texas TUSF rules supports the conclusion that Texas' regulatory framework since 2017 provides a robust system for monitoring and review of TUSF support payments, and the carrier reporting in Texas is more detailed than that provided in other states with major state USF programs.

Conclusions and recommendations

This updated TUSF report relies on concepts and historical data supplied in a 2016 Report prepared by the authors. Key new conclusions in this current report are:

- The size of the overall TUSF has contracted at a -7.3 percent CAGR since 2013
- Network-related support is lower since 2013, shrinking at a -7.5 percent CAGR
- SRILEC high-cost support has expanded marginally at a 1.3 percent CAGR since 2013 for the SB 586 Reporting Carriers that at the time the legislation was passed served less than 31,000 access lines
- Mid-size carrier support, including SRILEC support for those carriers, has contracted at a -10.1 percent annual rate, in part because certain larger carriers no longer receive support
- The recent problem identified in mid-2020 by the PUCT is that the Texas voice telecommunication revenue pool, which is the source of funding for TUSF, is shrinking, notably because of the recategorization of certain wireless revenues as broadband revenues
- The PUCT has robust mechanisms by which to monitor and assess the use of TUSF support and those mechanisms are detailed and thorough compared with the other major state USF programs reviewed by the authors

PROPER USE OF TUSF BY HIGH-COST CARRIERS

The PUCT is required by legislation to adjust the TUSF contribution factor to assure sufficient support for critical high-cost networks that are maintained by small and mid-size Texas carriers. There does not appear to be any dispute—based on the data or PUCT comments—that the support levels assigned to these telecommunications providers are justified, based on the detailed small carrier filings. The PUCT has focused in late 2020 and early 2021 on the question of whether to raise the TUSF contribution factor in order to generate sufficient revenues to meet the designated support levels required by these carriers. The PUCT does not appear to contest the carriers' need for this support; there have been no proceedings alleging that any companies or cooperatives have abused funds or that any of their individual support levels should be adjusted downward. But, by not raising the contribution factor, the PUCT is committing to at least a period when there is insufficient TUSF support, putting at risk TUSF recipients' ability to continue to serve customers in high-cost areas. Based upon an extensive review of carrier filings to the PUCT, TUSF recipients are following applicable laws and rules, and continue to rely on TUSF support to operate and serve rural Texans.

The PUCT has focused in late 2020 and early 2021 on the question of whether to raise the TUSF contribution factor in order to generate sufficient funding to meet the designated support levels required by these carriers. The PUCT is not contesting the carriers' need for this support.

RISK FOR SHARPLY REDUCED SERVICES OR FINANCIAL DISTRESS

The TUSF-supported statewide telecommunications network is critical infrastructure designed to keep all Texans connected. Without predictable and sufficient TUSF, there is a probable risk that Texans—urban and rural—may no longer benefit from a reliable statewide telecommunications network, at least in large geographic regions. The authors' experience in the telecommunications industry leads to the conclusion that even a short-term underfunding of TUSF puts at risk investment and service to customers, as well as the viability of carriers that require a stable revenue base and long investment horizons. A failure to fully-fund the TUSF is likely to result in reductions in services to low-density, rural regions and protracted underfunding risks the viability of the carriers serving customers across large portions of Texas, thus increasing the digital divide. Importantly, the potential damage to the network and the harm

to customers could be difficult to reverse in a high-fixed cost business where long-lived and costly assets must be maintained.

THE TEXAS LEGISLATURE’S TUSF POLICY IS CLEAR

The Texas Legislature’s policy and mandate regarding TUSF are clear and entirely consistent with the spirit and letter of the federal law in the Telecommunications Act. Both the state and federal legal frameworks are directed toward assuring a statewide network through combined federal and state USF support. TUSF remains a critical mechanism which, if underfunded could result in the failure of universal service for Texans who depend upon ubiquitous communications access and connectivity, which has been made abundantly clear through the COVID-19 pandemic.

TUSF remains a critical mechanism which, if underfunded could result in the failure of universal service for Texans who depend upon ubiquitous communications access and connectivity.

Appendix A: 2020 First RFIs sent to carriers

The PUCT issued Requests for Information (“RFIs”) to all TUSF recipients in Project No. 51433 on October 19 and required responses by December 3. The RFIs appear below.

- Staff 1-1 Please provide a list of all entities that use any of the Company’s telecommunications plant in service for which the Company seeks Texas Universal Service Fund (TUSF) monies.
- Staff 1-2 For each entity listed in Staff 1-1 above:
- identify the entity by name;
 - designate the entity as regulated or non-regulated;
 - designate the entity as affiliate or non-affiliate;
 - identify the plant assets used by the entity;
 - list the services provided by the entity; and
 - provide the amount of 2017, 2018, and 2019 reported revenues by entity.
- Staff 1-3 For each entity listed in Staff 1-1 above, please provide the amounts incurred by major expense category, including, but not limited to, operations and maintenance (O&M) expenses, taxes by type, and depreciation expense. Provide the amounts for 2017, 2018, and 2019.
- Staff 1-4 Please provide the amount of TUSF disbursements made to the Company for use of its telecommunications plant in service for 2017, 2018, and 2019
- Staff 1-5 For each incidental activity that does not constitute a line of business for the Company, please provide a listing of the activity and the amount of revenues and expenses associated with the individual incidental activity for 2017, 2018, and 2019.
- Staff 1-6 Please provide the Company’s current calendar year revenues and expenses, as of June 30, 2020, related to providing basic local telecommunications service.
- Staff 1-7 Please identify any changes in the Company’s accounting treatment of revenues and expenses related to providing basic local telecommunications service since the reporting period of its most recent 16 TAC § 26.407 filing.
- Staff 1-8 Please provide the amount of TUSF monies received by the Company since the inception of the TUSF.
- Staff 1-9 Please provide the amount of TUSF monies received per customer for 2017, 2018, and 2019.
- Staff 1-10 Please provide copies of monthly customer bills for basic local telecommunications service for ten different customers for the period July 2019 through June 2020.
- Staff 1-11 For the previous 12 months, please provide copies of any advertisements used by the Company or its affiliates that include an offer of basic local telecommunications services.
- Staff 1-12 Please provide the contact information available to customers receiving basic local telecommunications service for questions about billing, service, or reporting loss of service.

- Staff 1-13 Please provide the contact information available to customers receiving non-regulated services for questions about billing, service, or reporting loss of service.
- Staff 1-14 Please provide the methodology used by the Company to allocate expenses and revenues, along with examples and percentages, between basic local telecommunications services and non-regulated services.
- Staff 1-15 Please explain how the Company allocates labor between basic local telecommunications services and non-regulated services.
- Staff 1-16 Please explain how the Company allocates overhead between basic local telecommunications services and non-regulated services.
- Staff 1-17 Please provide a copy of the Company’s most recent vehicle study used to develop a separation of cost.
- Staff 1-18 Please provide a copy of the Company’s most recent building study used to develop a separation of cost.
- Staff 1-19 If the Company provides both basic local telecommunications services and non-regulated services over the same plant assets and a customer loses functionality of any or all services provided, please describe the process for determining the cause of the loss of function and the process for allocating costs to restore functionality of lost services.
- Staff 1-20 Please describe the process used by the Company for differentiating traffic over shared plant assets as either basic local telecommunication services or other, non-regulated services.
- Staff 1-21 Does the Company apply an apportionment standard for cost allocation that assumes network investment is either regulated or non-regulated based on utilization of the investment and that network investment is considered to be regulated services until it is used for non-regulated activities? If yes, provide the Company policy for determining that a network investment is considered used for non-regulated activities. Who makes the determination, and can the determination be challenged by the entities? If yes, please explain.
- Staff 1-22 Does the Company rely solely on the Cost Allocation Manual submitted in its 16 TAC § 26.407 filing for its annual accounting of regulated and non-regulated revenues and expenses? If the Company also relies on any other study or model, please provide a copy of the cost allocation study or model.
- Staff 1-23 Please provide copies of any internal or external audits performed during which the Company’s policies and procedures for allocating expenses were considered.
- Staff 1-24 Reference the Company’s Part 64 Study included in its most recent 16 TAC § 26.407 filing. Please provide a listing of all accounts during the previous five calendar years that were originally assigned 100% to the regulated function but that are now assigned less than 100% to the regulated function.
- Staff 1-25 Reference the Company’s Part 64 Study included in the most recent 16 TAC § 26.407 filing. Please provide a listing of all accounts during the previous five calendar years that were originally assigned less than 100% to the regulated function but that are now assigned

- 100% to the regulated function. Indicate the original percentage assigned to the regulated function.
- Staff 1-26 Please explain whether the Company constructs and maintains separate lines for basic local telecommunications services and non-regulated services.
- Staff 1-27 Please explain the type of line (e.g., copper, fiber) the Company uses to provide basic local telecommunications services and non-regulated services.
- Staff 1-28 Please provide the total length (in miles) of basic local telecommunications service lines the Company operates.
- Staff 1-29 Please provide the replacement schedule for the Company's basic local telecommunications service lines.
- Staff 1-30 Please provide the total length (in miles) of non-regulated service lines the Company operates.
- Staff 1-31 Please provide the replacement schedule for the Company's non-regulated service lines.
- Staff 1-32 Please explain what facilities are used by the Company to run basic local telecommunication service lines and non-regulated service lines.
- Staff 1-33 Please explain the Company's cost allocation for running or trenching lines. Please explain the Company's cost allocation for maintaining its lines.
- Staff 1-34 Please provide copies of any materials used by the Company for purposes of employee training related to labor distribution and timekeeping.
- Staff 1-35 Please explain how TUSF disbursement monies are used and accounted for in maintaining existing infrastructure.
- Staff 1-36 Please provide a list of all work order numbers related to new construction projects that were created since the Company's last plant in service prudence determination by the Commission. Include a detailed description of the work order's purpose, itemized costs charged to the work order, and method for determining costs to charge to the work order.
- Staff 1-37 Does the Company engage in any tying arrangements when offering basic local telecommunications service? If yes, please describe in full.
- Staff 1-38 Does the Company bundle basic local telecommunications services with non-regulated services? If so, please describe in full. Please explain the process followed by the Company to ensure cost recovery from the TUSF for basic local telecommunications services does not include costs related to the other bundled services.
- Staff 1-39 Please provide the Company's policies for ensuring that an offer of bundled services does not create a tying arrangement.
- Staff 1-40 For situations in which a customer requests basic local telecommunications service and, at the same time, requests another non-regulated service, please describe the Company's process for determining whether that request is a request for regulated service or a request for non-regulated service.

- Staff 1-41 Reference Schedule VIII of the Company’s 2017, 2018 and 2019 Annual Reports for Small ILECs. For each officer and director listed, please identify any other affiliated or non-regulated entity for which the individual serves as an officer or director. Please include the individual’s gross compensation for 2017, 2018, and 2019 before assignment of compensation to non-Texas activities, affiliates, or non-regulated accounts and activities.
- Staff 1-42 Has the Company ever participated in a Federal Communications Commission (FCC) audit? If yes, please provide a copy of all audit reports issued.
- Staff 1-43 Does the Company participate in an annual external audit of its regulated book and records? If yes, please provide a copy of the most recent audit report.
- Staff 1-44 Please provide the date and docket number of the final order in the Company’s most recent comprehensive base rate case before the Commission.
- Staff 1-45 Please provide the amount of plant in service deemed prudent by the Commission in the Company’s most recent comprehensive base rate case. Please provide the net book value of the prudent plant in service as of December 31, 2019.
- Staff 1-46 Please provide the amount of the Company’s December 31, 2019 plant in service balance for which the Commission has not determined prudence.
- Staff 1-47 Has the Company replaced any of its plant in service, for which it received a prudence determination in a previous rate case, with new plant in service that the Commission has not yet determined prudence? If yes, please provide the amount of prudent plant in service replaced and the amount of replacement plant in service.
- Staff 1-48 Please provide the amount of 2017, 2018, and 2019 TUSF funds collected by the Company related to plant in service for which the Commission has not determined prudence.
- Staff 1-49 Has the Company collected any amounts through the TUSF for services other than basic local telecommunications service? If yes, please provide the amount by type of service for 2017, 2018, and 2019 and explain the Company’s method for determining that collection of these amounts through the TUSF was proper.
- Staff 1-50 If the Company has received any amounts from the TUSF for recovery of expenses or plant in service related to its non-regulated functions, please provide the amount and the method by which the Company proposes to return such amounts.
- Staff 1-51 Has the Company received an ineligibility determination with respect to any Federal Universal Service Funds? If yes, please provide the amounts by year, along with a description of the basis for the ineligibility determination.
- Staff 1-52 Please indicate whether the Company is a member of an affiliated group eligible to file a consolidated income tax return and whether the Company was included in a consolidated income tax return for 2017, 2018, and 2019.
- Staff 1-53 If the answer to Staff 1-51 above is yes, please provide a copy of the 2017, 2018, and 2019 consolidated federal income tax return that included the Company.
- Staff 1-54 Given the imminent reduction in the TUSF, please provide the Company’s plans for continuing basic local telecommunication services to its customers.

Staff 1-55 Given the imminent reduction in the TUSF, please provide the Company's plans for continuing to provide non-regulated services that use the same plant assets as basic local telecommunication services.

Appendix B: 2020 specific RFIs sent to carriers

The PUCT Staff also sent standard RFIs, with slight company-specific modifications, to each of the small Texas carriers in the period from October 28 – December 2, 2020. The carriers supplied responses to the Staff's queries and attached supporting documentation, with the timing of the responses ranging from November 12 – December 18, 2020.

The PUCT Staff issued its final recommendation to each small carrier, citing the rule in 16 TAC § 26.407(f), which requires that Staff review the annual report, adjust for information filed by the utility, if necessary, and file a memorandum for the Commission's consideration regarding its determination of the appropriate earned rate of return. Based on its analysis, Staff then recommended that the carrier in question should be placed in Category 1, 2 or 3 in accordance with 16 TAC § 26.407(f)(3). For an explanation of the Categories, see page 28 above.

The following RFIs are drawn from requests sent to the small carriers, but with the elimination of the carrier name.

- Staff 1-1 Please provide the estimated or forecasted rate of return that Company A will report on its year-end 2020 and 2021 SB 586 reports. Please provide the underlying assumptions.
- Staff 1-2 Please provide a discussion of Company A's expected changes to plant in service and to total invested capital over the next five years. Please include a thorough explanation in the response and the expected in-service dates of any new investment.
- Staff 1-3 Please provide an explanation of any changes in Company A's operations in 2020 or expected changes in 2021 that should be considered in the evaluation of the 2019 SB 586 report.
- Staff-1-4 Please provide each docket or project number that authorized Company A to receive funds from the Texas Universal Service Fund (TUSF) for calendar year 2019 and the amount Company A was authorized to receive by each.
- Staff-1-5 Refer to Staff RFI No. 1-4. To the extent that the total of such authorizations does not tie to the amount reported for TUSF Revenue on Schedule I, line 6 of the report for calendar year 2019, please provide a detailed reconciliation and explanation(s). Such reconciliation should identify the calendar year to which each payment received from the TUSF and included in the TUSF Revenues on the 2019 calendar year report pertains as well as all journal entries (with detailed explanations and justifications) recorded on Company A's books, if any, that adjust the amount reported as TUSF Revenues on the 2019 report.
- Staff 1-6 Refer to Staff RFI Nos. 1-4 and 1-5. To the extent that the amount of TUSF revenues reported by Company A for the 2019 calendar year report reflects adjustments to remove TUSF Revenue received in 2019 that relate to prior periods, please provide copies of all journal entries for each such prior year where Company A accrued such amounts and included them in the TUSF Revenues for the annual report related to that year. If Company A did not accrue the amounts in prior years and now seeks to remove them from the 2019 report year, please provide a detailed explanation and justification for why such adjustment is reasonable and equitable.
- Staff 1-7 Please confirm that the Small and Rural Incumbent Local Exchange Company (SRILEC) Support listed in the "Sched 1 TUSF Details" is equal to the amount of "Adjusted Annualized

Support Amount” ordered on August 25, 2016 by the Commission in Docket No. 45809, Annual Adjustment to Support from the Small and Rural Incumbent Local Exchange Company Universal Service Plan Pursuant 5 to PURA § 56.032(d). If the amount is not equal, please provide a detail explanation for and reconciliation of the differences.

- Staff 1-8 Please explain whether Company A’s reported amounts at Schedule I, Line 10a and Line 22 comply with page 4’s Instruction for General Questions and Schedules for use in preparing the Annual Report for Small Incumbent Local Exchange Carriers (ILECs) under 16 TAC § 26.407. If not, please describe any discrepancies.
- Staff 1-9 Please provide all amounts received from the Federal Universal Service Fund (FUSF) during calendar year 2019. Please also provide a detailed explanation and justification of the determination of the intrastate portion.
- Staff 1-10 Refer to Staff RFI No. 1-9. Please provide a reconciliation with detailed explanations and justifications if the amount reported as FUSF Revenues for the calendar year 2019 report is different than the amount received during calendar year 2019. Such reconciliation should identify the calendar year to which each payment received from the FUSF and included in the FUSF Revenues on the 2019 calendar year report pertains as well as all journal entries (with detailed explanations and justifications) recorded on Company A’s books, if any, that adjust the amount reported as FUSF Revenues on the 2019 report.
- Staff 1-11 Refer to Staff RFI Nos. 1 - 9 and 1 - 10. To the extent that Company A made adjustments to remove amounts of FUSF Revenue reported in the 2019 report for amounts that relate to prior periods, please provide copies of all journal entries for each such prior year where Company A accrued such amounts and included them in the FUSF Revenues for the annual report related to that year. If Company A did not accrue the amounts in prior years and now seeks to remove them from the 2019 report year, please provide a detailed explanation and justification for why such adjustment is reasonable and equitable.
- Staff 1-12 Please provide all amounts Company A has received from the FUSF in calendar year 2020 to date that were for periods prior to 2020. Provide copies of all journal entries (if any) where those amounts were included in the annual reports for each prior period. If such amounts were not accrued and reported on the relevant prior period’s report, including calendar year 2019, provide a detailed explanation and justification for why not.
- Staff 1-13 Please identify all amounts that Company A has been notified that it will receive or otherwise has reason to expect to receive from the FUSF for the remainder of 2020 and subsequent periods that are related to calendar year 2019 and previous years. Identify each separately by year and dollar amount.
- Staff 1-14 Please provide the 2020 in-service dates for Company A’s reported 2019 short-term plant under construction. Please provide the information by project and include the associated cost.
- Staff 1-15 Please provide Company A’s September 30, 2020, short-term plant under construction balance.
- Staff 1-16 Do Company A’s 2019 intrastate expenses include amounts related to any nonqualified pension payments? If yes, please provide the amount.

- Staff 1-17 Do Company A's 2019 intrastate expenses include amounts for executive perquisites such as financial planning and tax gross-ups? If so, please provide an explanation of the types of perquisites, and include a copy of Company A's policies regarding the payment of such perquisites, and the amount of such payments included in the 2019 report.
- Staff 1-18 Please identify, by incentive plan type (short-term, long-term, etc.), and by entity (company direct, specific affiliate, etc.) all amounts included in Company A's 2019 intrastate expenses relating to financially based incentive compensation. For the purposes of answering this RFI, consider incentive compensation to be financially based if the incentive compensation's payment or amount of payment is based, in whole or in part, on the achievement of any financial metric, including any balance sheet metric, income sheet metric, blended metric, or other financial amount. For the purpose of answering this RFI, any incentive compensation which involves both financial and operational metrics shall be considered to be financially based incentive compensation.
- Staff 1-19 For the 2019 reporting period, please provide the number of access lines associated with customers that subscribed to basic local telephone service only.
- Staff 1-20 For the 2019 reporting period, please provide the number of access lines associated with customers that subscribed to non-regulated services in addition to basic local telephone service.
- Staff 1-21 Do the 2019 intrastate expenses include any amounts related to the preparation and processing of the 2017, 2018, or 2019 SB 586 reports? If yes, please provide the amount related to each report by expense type (legal, consulting, internal etc.).
- Staff 1-22 Do the 2019 intrastate expenses include any amounts related to the preparation and processing of other TUSF filings before the Commission? If yes, please provide the amount included, a breakdown of the expense by docket or project number, and a breakdown by expense types (legal, consulting, internal, etc.).
- Staff 1-23 Refer to Schedule I. Please explain and justify why uncollectible debt is added to revenues instead of subtracted.
- Staff 1-24 Refer to Schedule II of Company A's 2019 and 2018 reports. Please explain the decrease in the intrastate plant in service amount.
- Staff 1-25 Was the decrease in plant in service referred to in Staff RFI No. 1-24 the result of a retirement of a plant in service? If yes, please provide the journal entries used to record the retirement.
- Staff 1-26 Was the decrease in plant in service referred to in Staff RFI No. 1-24 the result of a sale of assets? If yes, please provide the sales price, gross plant value, accumulated depreciation, and use of proceeds from the sale.
- Staff 1-27 Refer to Schedule VI. Please explain and justify the increasing trend in net income or margins over the five years shown.
- Staff 1-28 Refer to Schedule VII. Please explain in detail and justify why Company A made the adjustment it made. Has Company A proposed such an adjustment before? Please explain what adjustments to future year reports Company A expects to make relating to this issue. Specifically, please answer whether Company A must make an adjustment to any future

- report based on the proposed adjustment to the current report. Please also specifically answer whether Company A expects to make a similar adjustment in future years.
- Staff 1-29 Refer to Schedule VII. Did the adjustment proposed in Schedule VII affect prior years? If so, please provide restated financials for prior years based on the adjustment made to this year's report.
- Staff 1-30 Refer to Schedule VIII for the 2018 and 2019 reports. Please explain and justify any increase or decrease in officers' pay. Please also specifically explain and justify any increase in officers' pay in light of Company A's continued need for TUSF support.
- Staff 1-31 Refer to Schedule VIII. Please explain and justify any officer's salary in excess of \$100,000. Please also specifically address and justify any such salary given Company A's continued need for TUSF support.
- Staff 1-32 Please provide a detailed explanation for all factors that caused the 2019 calendar year unadjusted and adjusted reported rate of return to increase dramatically from the 2017 and 2018 reported rates of return.
- Staff 1-33 Refer to the General Questions and Schedule II. Please explain and justify why the answer to the Question No. 11 on the General Questions does not equal the rate of return as shown and calculated on Schedule II.
- Staff 1-34 Please provide any other explanatory information that Company A believes is relevant to the information provided in its current and future SB 586 reports.