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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Consider Modifications to the California Advanced Services Fund.

Rulemaking 12-10-012
(Filed October 25, 2012)

ADMINISTRATIVE LAW JUDGE'S RULING SOLICITING ADDITIONAL COMMENTS ON ISSUES IDENTIFIED IN ORDER INSTITUTING RULEMAKING 12-10-012

The California Public Utilities Commission (Commission) established the California Advanced Service Fund (CASF) in Decision (D.) 07-12-054 and the Legislature subsequently authorized it in order to spur the deployment of broadband facilities in unserved and underserved areas of California. The CASF provides financial support in the form of grants for broadband infrastructure projects selected through an application and scoring process. In addition, it provides support to rural and urban regional broadband consortia to fund activities that are intended to facilitate broadband deployment other than funding the capital costs of specific deployment projects. The CASF also provides loans to finance the capital costs of broadband facilities not funded by a CASF grant.

In D.07-12-054, the Commission limited eligibility for CASF support to telephone corporations as defined by Pub. Util. Code § 234, i.e., entities that hold either a Certificate of Public Convenience and Necessity (CPCN) or a Wireless Identification Registration (WIR). The restriction on eligibility for CASF funding to telephone corporations was subsequently reflected in statute when the

Legislature codified the CASF. However, with the passage of the American Recovery and Reinvestment Act (ARRA) in February of 2009, which provided grants to both telephone corporations and other entities for the construction of broadband facilities, the Commission saw the opportunity to leverage existing CASF funds by providing CASF matching grants to ARRA grantees for the unfunded portion of ARRA grants. In July of 2009, Assembly Bill (AB) 1555 was enacted giving the Commission the authority to provide CASF matching grants to ARRA grantees that were not telephone corporations if those entities met the requirements of the Commission's CASF program. Subsequently, the Commission issued Resolution T-17233, which adopted specific rules governing the participation of non-certificated or registered entities in the CASF program, taking into account the concerns the Commission expressed in D.09-07-020. In order to ensure the financial, technical and managerial competence of CASF applicants which were not regulated by the Commission, the Commission imposed additional requirements on them, including: the submission of information sufficient to conduct a thorough background check; an affidavit agreeing to comply with specific Commission rules; an agreement to allow the Commission to inspect the applicant's accounts, books, papers, and documents related to the application and award of CASF funds; and a mandatory performance.

On October 25, 2012, the Commission issued Rulemaking (R.) 12-10-012 which proposed to change the CASF eligibility rules to allow certain commercial and nonprofit broadband service providers to apply for CASF grants and loans. A central issue identified in the rulemaking was what safeguards should be applied to these entities given that they are not subject to the Commission's regulatory authority. Opening and reply comments on this and other issues

identified in the Order Instituting Rulemaking (OIR) were filed by interested parties on December 3, 2012 and December 18, 2012. After reviewing the comments, we believe it is necessary to supplement the record on the safeguard issue before issuing a decision on the proposed change in eligibility rules.

This ruling seeks additional comments from interested parties in the above-referenced OIR. As discussed below in greater detail, we ask whether it is necessary to require these entities to maintain a performance bond equal to the full amount of a CASF grant once a funded project has been completed. In addition, we seek comments on our proposal to require these entities to demonstrate that they have sufficient liquidity to meet start-up expenses which may not be covered by CASF awards or external financing. Finally, we seek comment on our tentative proposal to enable the Commission to impose penalties on these entities if they violate the terms and conditions governing CASF awards.

Performance Bond

In opening and reply comments, several parties commented that if the Commission changes the CASF eligibility rules it should also adopt the performance bond requirements originally adopted in Resolution T-17233 (ARRA Resolution).¹ The ARRA Resolution implemented the provisions of AB 1555 which allowed non telephone corporations which had obtained Federal ARRA grants to apply for CASF support. As previously noted, because these entities, unlike CPCN or WIR holders, were not subject to the Commission's

¹ DRA at Opening at 8, Small LECs Opening at 3, TURN Opening at 2, CCTA Opening at 2, Frontier Opening at 5.

enforcement authority, the ARRA Resolution implemented specific safeguards governing their participation in the CASF program to ensure that ratepayer funds would not be subject to waste, fraud, or abuse. Among these safeguards was the requirement that such entities obtain a performance bond for the full amount of the grant. The purpose of the bond was to ensure project completion and compliance with the terms and conditions of the grant.

The bond requirements adopted by the ARRA Resolution for unregulated entities differed in key respects from those adopted in Resolution T-17143 for entities which held a CPCN or WIR. The Commission noted in the ARRA Resolution that the different requirements were necessary because entities which held a CPCN or WIR were under the regulatory purview of the Commission and, therefore, it could exercise punitive measures to enforce the terms and conditions of CASF awards which it could not do with respect to unregulated entities. Thus, while Resolution T-17143 waived the performance bond requirement for regulated entities that self-funded 60 percent of the project, the ARRA Resolution made the performance bond mandatory regardless of the ability of an unregulated entity to self-fund the portion of the project not funded by the CASF grant.² In addition, Resolution T-17143 required that regulated entities maintain the bond only until the project was completed while the ARRA Resolution required that unregulated entities maintain the bond for a period that extended well beyond the project completion date. This was largely to ensure compliance with the post construction pricing commitment and the requirement that a grantee make its books, accounts and other project related documents available

² Resolution T-17143 at 12, A-4 – 5; ARRA Resolution at 7.

to the Commission for inspection at any time for three years after project completion.³

While we believe the specific performance bond requirement adopted by the ARRA Resolution is appropriate up until the project is completed, we have reservations about applying the identical requirements during the post project completion period even though the Commission has a continuing obligation for three years to ensure compliance with terms and conditions of the award. These reservations are based on our experience with unregulated ARRA grantees which received CASF awards. The two unregulated providers which obtained CASF grants under the ARRA resolution subsequently decided to obtain a CPCN. In one case, the provider acquired the CPCN of one of its affiliates because it found it was unable to obtain a performance bond that met the ARRA Resolution requirements. Moreover, the difficulty it experienced in obtaining the bond was not attributable to the financial soundness of the provider, or any other suitability factor, which could cause an insurance company to decline a request to issue a bond. Rather, it was attributable to the bond requirements which, among other things, required the provider to maintain a bond for the full amount

³ See Resolution T-17143 at 12 which states that the performance bond obtained by an entity holding a CPCN or WIR terminates upon completion of the project. While the ARRA resolution states only that the performance bond required of unregulated entities is “callable in cases of non-completion, non-compliance with the terms and conditions of the CASF award, and failure to open its books to the Commission for inspection,” it states that all other requirements identified in Resolution T-17143 should apply to unregulated grantees. These requirements include a one year pricing commitment and the requirement that grantee make its books of account available to the Commission at any time up to three years after the date the project is completed. See Resolution T-17143 at 14-16 and Appendix A at 14. In D.12-02-015, the Commission extended the pricing commitment to two years. See D.12-02-015 at 11.

of the award even after the project was completed. Given the experience of this provider, we are concerned that if the Commission changes the CASF eligibility requirements, but conditions that change on the specific bond requirements adopted in the ARRA Resolution few, if any, unregulated providers will be able to obtain a performance bond, effectively rendering the change in eligibility meaningless. Based on this concern, we seek additional comments from the parties on potential changes to the performance bond requirements adopted in the ARRA Resolution which will provide reasonable assurance that ratepayer money will be protected, but will be obtainable from an insurance company assuming the service provider has the requisite financial, technical, and managerial capabilities.

Based on our analysis, it appears unnecessary to require an awardee to hold a performance bond for the full amount of the award after completion of the project, particularly if doing so makes obtaining a bond unduly onerous or potentially impossible. The primary function of the performance bond is to protect funds in the event the approved project is not completed or does not meet the specifications proposed in the application. Once the project has been constructed and its operational capabilities have been verified, a substantial portion of the risk to ratepayers has been eliminated. For example, following the completion of the project, it is possible that the awardee will fail to meet the post construction pricing commitment. However, it is hard to imagine how an awardee's failure to meet the pricing commitment would justify requiring the awardee to hold a bond for the full amount of the grant. Similarly, an awardee's failure to allow the Commission to inspect its books and accounts during the three year period following project completion would impair the Commission's ability to uncover an awardee's mistakes in accounting or deliberate

misallocation of funds. Such acts would require the awardee to reimburse misallocated funds to the Commission. However, since the CASF program closely scrutinizes invoices submitted by awardees prior to dispersing CASF funds, Staff does not believe that accounting errors or other misappropriation of funds would approach anything near the full amount of the project award. Finally, while there is always the possibility that large scale fraud would be uncovered or become manifest after the completion of the project, we believe the chances of such fraud not being detected prior to the completion of the project or becoming manifest only after the project's completion are remote.

In light of this analysis, we seek comment on the appropriateness and feasibility of reducing the post project completion performance bond requirement to an amount that is less than the full amount of the project award. To the extent parties believe the bond amount should be reduced, we ask by what amount expressed as a percentage of the award. Since it is necessary to ensure that an awardee has obtained a bond before any funds are dispersed, we also ask how we might structure a bifurcated bond requirement.

Liquidity Requirement

The ARRA Resolution required unregulated entities to submit the same financial information that applicants which held a CPCN or WIR were required to submit pursuant to Resolution-T-17143. The Commission required the submission of this information so that it could assess the financial fitness of an applicant prior to awarding it a CASF grant. If the Commission changes the eligibility rules as proposed in the OIR, we intend to apply this requirement to unregulated entities as well. The financial information required would include not only information relevant to assessing the financial fitness of an applicant

that was required under the ARRA Resolution and Resolution T-17143, but also the financial data required by the Commission in D.12-02-015.

While CASF applicants are required to submit information that enables the Commission's Communications Division (CD) to assess the applicant's financial fitness as part of the review of an applicant's request for CASF support, the Commission has not identified any specific financial requirements which an applicant must meet as a condition of being awarded a CASF grant. However, a CASF applicant which holds a CPCN would have been required to show that it has sufficient cash or cash equivalents on hand to cover the start-up costs of the firm as a condition of being granted a CPCN. As an added safeguard, we believe that adopting a liquidity requirement for unregulated CASF applicants that is similar, but not identical, to the demonstration required of applicants for a CPCN will assure that unregulated broadband service providers receiving CASF support are capable of meeting start-up expenses over and above those covered by a CASF grant or loan or any external source of funding. We recognize that we may receive applications for CASF support for both small and large projects. For this reason, we do not wish to impose a one size fits all requirement on unregulated broadband service providers that seek CASF support. Thus, we propose requiring any unregulated entity seeking CASF support to demonstrate that it has the greater of \$25,000 or 10% of the total project cost in cash or cash equivalents on hand, capped at a total of \$100,000.

We seek comments from the parties on this proposal. Is the amount proposed sufficient or excessive? Is the requirement appropriate for an applicant seeking funds for a project that is less than or equal to \$225,000 when the cash requirement would represent at least 20% of the project cost? Is it necessary to impose this requirement on an established provider who seeks CASF funds to

upgrade facilities or expand existing operations when its existing financials show that its current operations are profitable? Finally, how do we reconcile imposing this requirement on unregulated entities and not on applicants which hold a CPCN given that the latter may not have the same cash or cash equivalents on hand at the time they file an application for CASF funds?

Penalties

The Public Utilities Code gives the Commission the authority to impose penalties for violation of the Commission's rules and orders. Public Utilities Code 2111 provides that: "Every corporation or person, other than a public utility and its officers, agents, or employees, which or who knowingly violates or fails to comply with, or procures, aids or abets any violation of any provision of the California Constitution relating to public utilities or of this part, or fails to comply with any part of any order, decision, rule, direction, demand, or requirement of the commission, or who procures, aids, or abets any public utility in the violation or noncompliance, in a case in which a penalty has not otherwise been provided for the corporation or person, is subject to a penalty of not less than five hundred dollars (\$500), nor more than fifty thousand dollars (\$50,000) for each offense." Public Utilities Code Section 2108 defines an offense: "Every violation of the provisions of this part or of any part of any order, decision, decree, rule, direction, demand, or requirement of the commission, by any corporation or person is a separate and distinct offense, and in case of a continuing violation each day's continuance thereof shall be a separate and distinct offense."

We propose that, as a condition for accepting CASF grants, receiving entities be contractually obligated to comply with Commission rules and statutes. We believe that entities receiving CASF grants must comply with their

stated deployment and operational milestones and that willful or fraudulent failure to do so will subject them to sanctions and an appropriate fine.

IT IS RULED that further comments on the issue of safeguards and penalties as identified in the above-referenced rulemaking are solicited as described above. Opening comments are due 15 business days from the issuance of this ruling. Reply comments are due 10 business days thereafter.

Dated March 18, 2013, at San Francisco, California.

/s/ W. ANTHONY COLBERT
W. Anthony Colbert
Administrative Law Judge