Agenda Date: June 16, 2003
Item Number: A6, A10

Docket: **UT-030867 and UT-030891**
Company: BG Enterprises, d/b/a/ Grizzly Telephone
Tel West Communications LLC

Staff: Glenn Blackmon, Assistant Director-Telecommunications

RE: **Supplemental Information on the Obligation to Offer WTAP Service**

At the WUTC's June 11, 2003 open meeting, the Commission considered petitions from the companies listed above requesting that they be exempted from WAC 480-122-020. This rule requires that local exchange companies serving residential customers offer discounted service to qualifying low-income customers through the Washington Telephone Assistance Program.

This memorandum provides additional information to assist the Commission in considering whether to grant these requests.

As Staff noted in its June 11 memo, the petitioners assert that they cannot afford to participate in the WTAP program because the Department of Social and Health Services has reduced the level of reimbursement. Before June 1, 2003, each local exchange company received the difference between its retail rate and the WTAP rate, which is currently $4.00 per month. Effective June 1, 2003, incumbent local exchange companies receive the same amount, but competitive local exchange companies (including the petitioners) receive the same amount as the incumbent company in the exchange where service is provided.

Staff suggested that, even if the petitioners' existing service arrangement is not profitable at the reduced WTAP reimbursement level, the companies can nonetheless fulfill the WTAP obligation by reselling the WTAP service of the incumbent local exchange companies (ILECs).

Competitive local exchange companies have the right under federal law, 47 USC 251(c)(4) and 47 USC 252(d)(3)[1], to purchase telecommunications services at a

[1] Sec. 252(d)(3) states:

discount from ILECs and resell those services to retail customers. The discount is to be determined based on the retail rate, minus the portion of the rate "attributable to any marketing, billing, collection, and other costs that will be avoided" by the ILEC.

The WUTC prescribed the avoided cost discounts for Qwest and Verizon in Docket UT-960369. The discount is 10.1% for Verizon, and 14.74% for Qwest.

The petitioners currently receive these discounts when they purchase local service from Qwest and Verizon. Qwest's retail rate for residential local service is $12.50, and the resellers can purchase that service for $10.66. Verizon's retail rate for residential service is $13.00, and the resellers can purchase it for $11.69.

The current arrangement for serving WTAP customers via resale is for the reseller to purchase service from Qwest and Verizon at the wholesale prices noted above. They would sell local service to the WTAP customer for $4.00 per month, and they would collect subsidy money from WTAP and, in some cases, from the federal low-income program. The sum of these subsidy payments and the customer payment were well in excess of the charges paid to Qwest and Verizon. The WTAP payments have now been significantly reduced, to the point that the sum of the subsidy and customer payments is in some cases insufficient to cover the charges to Qwest and Verizon.[2]

However, Staff does not believe that this necessarily mean that a reseller should be excused from their obligation to offer WTAP service, because it could arrange its service such that the ILEC is responsible for collecting subsidy payments from the state and federal programs.[3] Under this arrangement, the reseller would purchase the ILEC's WTAP service at the resale discount and would in turn sell

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> Wholesale prices for telecommunications services. For the purposes of section 251(c)(4) of this title, a State commission shall determine wholesale rates on the basis of retail rates charged to subscribers for the telecommunications service requested, excluding the portion thereof attributable to any marketing, billing, collection, and other costs that will be avoided by the local exchange carrier.

[2] One source of the discrepancy between the reimbursement of resellers and ILECs is the treatment of toll blocking charges. Qwest and Verizon charge resellers approximately $2.00 per month for toll blocking. However, Qwest and Verizon cannot charge retail WTAP customers for toll blocking, and the WTAP program in turn does not reimburse Qwest and Verizon for their retail toll blocking costs. Therefore, the resellers incur toll blocking expenses that are not covered by the revised WTAP reimbursement rule and cannot be collected from the WTAP customer.

[3] Another alternative – for the reseller to use an "unbundled network element platform" arrangement – is discussed in Staff's June 11 memo.

that service to the WTAP-eligible customer.[4] The table below shows the margin that a reseller would receive under this arrangement:

	Qwest	Verizon
ILEC retail WTAP rate	$4.00	$4.00
Wholesale rate paid by reseller	$3.41	$3.60
Margin to reseller	$0.59	$0.40

As Staff noted on June 11, these are very thin margins for the reseller. The margins are unlikely to be sufficient to cover the billing, collection, and customer service costs attributable to WTAP customers. However, any loss to the reseller from serving a WTAP customer is modest. While this margin would not support a stand-alone WTAP service, it may be sufficient when a reseller is serving the general residential market and a proportionate number of WTAP customers.

Moreover, because the resale discount is calculated as a percentage of the retail rate, the reseller's margins will increase if the WTAP rate is increased. For example, if the WTAP rate were to increase to $9.00 per month, the margins would more than double, as illustrated in the table below:

	Qwest	Verizon
ILEC retail WTAP rate	$9.00	$9.00
Wholesale rate paid by reseller	$7.67	$8.09
Margin to reseller	$1.33	$0.91

Even with these greater margins, Staff cannot conclude that these margins are sufficient to cover the reseller's costs, since the reseller's costs are not known.

If the resellers were to demonstrate that the margins shown above are insufficient to make WTAP service financially viable, the Commission could consider increasing the size of the discount as an alternative to eliminating the WTAP obligation. It is reasonable to believe that the current resale discount, when applied to WTAP service, is less than the actual costs avoided by the ILEC. Therefore a larger discount may be justified for this service.

[4] This is the arrangement that the Federal Communications Commission prefers for resellers. The federal program does not permit pure resellers to receive low-income universal service support. Instead, the underlying carrier is allowed to collect support on resold lines.

There are two basic reasons why the resale discount, when applied to WTAP service, is likely inadequate. First, it is determined on a percentage basis, which causes the dollar amount to be smaller when the retail rate is smaller. For example, Qwest's resale discount of 14.74 percent, when applied to a typical residential customer bill of about $20.00, produces a reseller discount of $2.95. In other words, it costs Qwest about $2.95 per customer, per month for retailing functions, such as marketing, billing, and customer service. There is no reason to expect these costs to be lower when Qwest serves a WTAP customer than when it serves other residential customers. Therefore, $2.95 is probably a more accurate measure of the actual costs avoided by Qwest through resale. The resale discount, calculated as a percentage of the WTAP rate, would properly be 73.7 percent rather than 14.74 percent.[5] This appears to be a much larger discount, when stated in percentage terms, but it actually produces the same dollar amount, matching Qwest's avoided retailing costs.

Second, the local exchange companies appear to believe that the retailing costs associated with WTAP customers are actually higher than what they incur to service other residential customers. Staff has no evidence to support this contention. However, if it is correct, then Qwest and Verizon actually avoid more costs when a reseller serves a WTAP customer than they avoid when a reseller serves other residential customers. The avoided cost standard in 47 USC 252(d)(3), applied specifically to WTAP service, would produce an even larger reseller discount.

Staff believes that the Commission should consider these corrections and refinements to the avoided cost calculation in deciding whether to excuse resellers from the obligation to serve WTAP customers. The analysis suggests that, if service to WTAP customers is shown to be an economic burden on resellers, the problem lies not with the WTAP customers or the level of reimbursement by the WTAP program[6] but rather with the inappropriate application of 47 USC 252(d)(3) to the WTAP service.

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[5] If the WTAP rate were increased to $9.00, the retail-related avoided costs would remain $2.95. Therefore the avoided cost discount, as a percentage rate, would be 32.77 percent.

[6] This is not to say that there are no problems with the reimbursement formula when applied to resellers. As noted above, there appears to be a discrepancy in the treatment of toll blocking charges.