

## **Phone Plus Magazine: 3/2000**

### **Identity Crisis**

#### **Should You Be A Reseller Or Distributor?**

*By Neil S. Ende*

In the telecom world, perhaps more than any other, a company's regulatory status may be determined as much by how the company describes itself as by how it operates.

Providers of voice-grade services often are regulated, while providers of "enhanced services" may not be. Resellers often are regulated; distributors generally are not.

Despite the enormous consequences these differences can have on the manner in which telecommunications businesses are operated and on their profitability, very few such businesses take the time to consider these issues when determining how they will describe and operate their business.

Even more troubling, perhaps, is that many companies' agreements fail to properly reflect the manner in which they actually do business. So, before you step into the regulatory abyss or enter into business relationships with your suppliers and customers, it is critical to consider carefully how you describe your operations, why you operate in the manner you've chosen and whether your business could operate in a way that would limit your regulatory exposure or allow you to enter into other lines of business with a minimum of cost and delay.

#### **Defining Terms**

Although the term "resale" has been the subject of endless debate in the regulatory community for several decades, as a general matter, a reseller is an entity that purchases a service or product from a supplier (usually a telecommunications carrier), sets the price of that service or product, and sells it under its own name to its customers.

The essential elements are a purchase and a sale under the reseller's name. Resellers are generally arbitrageurs. They take advantage of and make their profit from the spread between the wholesale price obtained by purchasing at volume and the higher retail price generally available to end-user customers. In most circumstances, the resale process is regulated at the federal and state levels.

A distributor is differentiated from a reseller on each of these issues. Unlike a reseller, a distributor does not "purchase" a service or product from a supplier, nor does it "sell" that product under its own name.

In the telecommunications context, a distributor is an agent of the supplier (telecommunications carrier), selling the carrier's service or product at rates, terms and conditions set by the supplier. The distributor makes its "profit" through a commission the supplier pays for selling the supplier's service or product.

Absent unusual circumstances, the distribution of telecommunications services and products is not subject to regulation.

The reason for the difference between the regulatory treatment accorded resellers and distributors is simple and a byproduct of the inherent distinction between the act of resale and act of distribution.

Regulators are concerned with protecting "the public interest." In a practical sense, this means regulators are concerned about the quality, price and availability of telecommunications services to the residents of their state or the citizens of the country.

In a number of states, regulators have relaxed their scrutiny over interexchange services, concluding market forces, such as vigorous competition, provide adequate protection against misbehavior. Where competition is not deemed to provide adequate protection, regulators use a variety of devices, including certification and tariffing, to ensure customers are not overcharged and that the terms and conditions of service are just and reasonable.

By their nature, these regulatory devices are directed at the supplier and resellers of the telecommunications services and products and not at the entities that distribute those services and products. This is because suppliers and resellers set the rates, terms and conditions under which the services and products are sold; distributors do not. Thus, regulations requiring certification and/or tariffing are imposed on suppliers and resellers and not on distributors.

### **Choosing Sides**

So--how do you decide if you are or should be a reseller, subject to regulation, or a distributor who is not?

*Reseller Side.* There is no question the advantages of being a reseller can be significant. As a reseller, you purchase the services you require from one or more service providers and sell those services to your customers in the manner you see fit. You can have facilities, if you want, and you can deal with as many service providers as you wish.

The services are sold and billed under your name, and you set all rates, terms and conditions applicable to the services. If you decide to sell the business, it is yours to sell (assuming your supplier agreements are assignable), and it will have a reasonably definable value based on the size and nature of your customer base.

However, it is important to know that the costs of being a reseller are also quite significant. Control over the rates, terms and conditions of service comes at a significant cost. You will need to obtain regulatory approvals at the state and federal levels, and you will need to file multiple state and federal tariffs (*See "Reality Check: It May Be Time for a Regulatory Audit," PHONE+, December 1999*).

In addition to these up-front filing requirements, you will need to maintain the completeness and accuracy of your tariffs to ensure they reflect the rates, terms and conditions under which services are then being provided.

As a reseller, you also will be obligated to file periodic reports with the FCC and with a myriad of state regulatory authorities. The fees and expenses associated with these initial filings can run in excess to \$50,000, and annual compliance costs can run up to \$20,000.

As a reseller, you also will need to establish and maintain the infrastructure necessary to provide customer service, to bill your customers and to collect from them.

Although these services can be outsourced, it can be quite expensive to do so. As a reseller, you will face the risks of bad debt and ever-present risks associated with your day-to-day supplier relationships. These risks include billing disputes, rate changes, quality of service issues, customer service obligations. (Some of these risks are discussed in previous articles, such as "Unholy Contract: The Legacy and Abuse of the Filed Rate Doctrine," *PHONE+*, May 1999 and "Carrier Contracts: A Minefield of Avoidable Risk," *PHONE+*, August 1999.) In short, operating as a reseller has substantial benefits and potential risks.

*Distributor Side.* Distributor arrangements have a different set of pluses and minuses. A key benefit of the distribution arrangement is the cost of entry is normally much lower. In most cases, a distributor can commence business without prior regulatory approval.

As a general matter, a distributor's cost of doing business is also much lower, because it does not have to provide or outsource any of the underlying services or the billing or associated therewith.

At the same time, and contrary to popular belief, there is not necessarily a difference in the level of "profit" derived as a reseller versus a distributor. With proper counsel, entities can structure distribution relationships where the "commission" they are paid for selling the supplier's service is similar in amount to the wholesale/retail spread they would have earned as a reseller. Thus, in many circumstances, it may be to your economic advantage to consider a properly structured distribution arrangement rather than a resale arrangement.

The most critical difference between a resale arrangement and a distribution arrangement is, in a distribution context, it is the supplier, not the distributor, who "owns" the end-user customer.

This is particularly true in the context of 1+ services, where the end user normally will be presubscribed to the supplier's network. (It is less true in the context of debit cards where there frequently is no direct relationship between the supplier and the end-user customer.)

Thus, as a distributor, you normally will have neither a customer base nor other hard assets to sell. The value of your business will be based on your distribution network and your commission stream.

Moreover, as a distributor, you are dependent on the rates, terms and conditions set by your supplier(s) and the competitiveness of the services available from those supplier(s). These factors can make it more difficult to properly value the present and future value of your assets and thus to obtain an appropriate sales price.

In short, there is no absolute answer as to whether it is better to be a reseller or a distributor. In most cases, the answer depends on the marketplace you serve, the nature of your expertise and your overall business strategy.

Whatever you decide, it is critical your agreements properly reflect the specifics of your business arrangement--clearly distinguishing between resale and distribution--and you operate in a manner consistent with those agreements. If you take these steps, you can operate successfully as either a reseller or a distributor of telecommunications services.

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