MCWHIRTER REEVES
ATTORNEYS AT LAW

December 7, 2001

VIA HAND DELIVERY

Blanca S. Bayo, Director
Division of Records and Reporting
Betty Easley Conference Center
4075 Esplanade Way
Tallahassee, Florida 32399-0870

Re: Docket No.: 990649A-TL

Dear Ms. Bayo:

On behalf of the Z-Tel Communications, Inc., enclosed for filing and distribution are the original and 15 copies of the following:

▶   Testimony and Exhibit of George S. Ford

Please acknowledge receipt of the above on the extra copy of each and return the stamped copies to me. Thank you for your assistance.

Sincerely,

Joe McGlothlin

Joseph A. McGlothlin

JAM/mls
Enclosure

APP
CAF
CMP
COM
CTR
ECR
LEG
OPC
PAI
RGO
SEC
SER
OTH

RECEIVED & FILED

FPSC-BUREAU OF RECORDS

DOCUMENT NUMBER-DATE

15364 DEC-7 ö

FPSC-COMMISSION CLERK

RECEIVED-FPSC
01 DEC -7 PM 4:45
COMMISSION CLERK

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Investigation into)   Docket No. 990649A-TP
pricing of unbundled network)
elements)   Filed: December 7, 2001
_____)

TESTIMONY AND EXHIBIT

OF

GEORGE S. FORD

ON BEHALF OF

Z-TEL COMMUNICATIONS, INC.

1   Q.   PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

2   A.   My name is George S. Ford. I am the Chief Economist for Z-Tel

3   Communications, Incorporated (Z-Tel). My business address is 601 South

4   Harbour Island Boulevard, Suite 220, Tampa, Florida 33602.

5   Q.   BRIEFLY DESCRIBE YOUR EDUCATIONAL BACKGROUND AND

6   RELATED PROFESSIONAL EXPERIENCE.

7   A.   I received a Ph.D. in Economics from Auburn University in 1994. My

8   graduate work focused on the economics of industrial organization and

9   regulation, with course work emphasizing applied price theory and

10   statistics. In 1994, I became an Industry Economist for the Federal

11   Communications Commission's Competition Division. The Competition

12   Division of the FCC was tasked with ensuring that FCC policies were

13   consistent with the goals of promoting competition and deregulation

14   across the communications industries. In 1996, I left the FCC to become a

15   Senior Economist at MCI WorldCom where I was employed for about

16   four years. While at MCI WorldCom, I performed economic studies on a

17   variety of topics related to federal and state regulatory proceedings. In

18   May 2000, I became Z-Tel's Chief Economist.

19   In addition to my responsibilities at Z-Tel, I maintain an active

20   research agenda on communications issues and have published research

21   papers in a number of academic journals including the *Journal of Law and*

1

1   *Economics,* the *Journal of Regulatory Economics,* and the *Review of Industrial*

2   *Organization,* among others. I am also a co-author of the chapter on local

3   and long distance competition in the *International Handbook of*

4   *Telecommunications Economics.* I often speak at conferences, both at home

5   and abroad, on the economics of telecommunications markets and

6   regulation.

7   Q.   **COULD YOU DESCRIBE Z-TEL'S SERVICE OFFERINGS?**

8   A.   Z-Tel is a Tampa-based, integrated service provider that presently

9   provides competitive local, long distance, and enhanced services to

10   residential consumers in thirty-five states, including New York,

11   Pennsylvania, Massachusetts, Texas, Michigan, Georgia, Illinois, among

12   others. Z-Tel plans to expand nationally as the unbundled network

13   element platform ("UNE-P") becomes available at TELRIC rates. The

14   company's goal is to offer a competitive service to the residential

15   consumers of every state.

16   Z-Tel's service is not just a simple bundle of traditional

17   telecommunications services. Z-Tel's service is unique in that it combines

18   its local and long distance telecommunications services with Web-based

19   software. This consideration enables each Z-Tel subscriber to organize his

20   or her communications, including email, voicemail, fax, and even a

21   Personal Digital Assistant ("PDA"), by accessing a personalized web-page

1   via the Internet. In addition, the personal Z-Line number can be

2   programmed to follow the customer anywhere he or she goes, via the

3   "Find Me" feature. Other service features include low long distance rates

4   from home or on-the-road and message notification by phone, email, or

5   pager. Customers can also initiate telephone calls (including conference

6   calls in the near future) over the traditional phone network, using speed-

7   dial numbers from their address book on their personalized web page.

8 Q.   **WHAT INTEREST DOES Z-TEL COMMUNICATIONS HAVE IN**

9   **THIS PROCEEDING?**

10 A.   Z-Tel's service is a bundle of many different communications services

11   including voicemail, email, fax, Internet, PDAs, and local and long

12   distance telecommunications into an easy-to-use communications control

13   center. An important element of that bundle is local exchange

14   telecommunications service. To provide the local exchange portion of its

15   service offering, Z-Tel must purchase unbundled network elements from

16   incumbent local exchange carriers like BellSouth. At present, Z-Tel's

17   primary means of providing local exchange service provision is UNE-P.

18   Because Z-Tel is dependent upon the local exchange carrier's UNEs to

19   provide service at this time, Z-Tel has a strong interest in ensuring the

20   rates established for UNEs are TELRIC compliant and conducive to

21   competitive entry.

1   Q.   **WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

2   A.   I will describe and perform a "sanity test" of BellSouth's loop rate that can

3   assist the Commission in determining whether the rate meets the required

4   TELRIC standard. BellSouth's loop rate fails the test. In my opinion, the

5   results of this independent sanity test render the loop rate initially

6   suspect, and indicate the need to scrutinize BellSouth's model and

7   individual inputs. It is my understanding that witness Brian Pitkin has

8   performed such an analysis and has concluded that BellSouth has

9   overstated its loop costs.

10   Q.   **PLEASE DESCRIBE THE "SANITY TEST" TO WHICH YOU REFER.**

11   A.   The test derives from the method that the FCC uses, for purposes of

12   Section 271 applications, to assess the reasonableness of the UNE cost

13   rates across the states in which in ILEC does business.

14   The FCC's methodology, which I refer to as the TELRIC Test, is laid out

15   clearly in its Oklahoma-Kansas 271 Order at ¶84-5. It has since been

16   applied in the subsequent 271 Orders including Massachusetts,

17   Pennsylvania, and Arkansas and Missouri. In applying the method, the

18   FCC uses its Hybrid Cost Proxy Model ("HCPM" or "USF cost model") to

19   determine the relative cost of loops across the states of an ILEC. For

20   example, according to the HCPM, the average cost of a loop is roughly 9%

1   less in Florida than in Georgia. Loop costs are roughly 24% less in Florida

2   than in Louisiana. The FCC then compares the relative UNE rates across

3   states to determine if such differences are consistent with the estimated

4   cost differentials as measured by the HCPM. To illustrate, if the loop rate

5   in Georgia was, say, $10, then the loop rate in Florida should be about

6       $9.10, or 9% less than in Georgia. The state that establishes the standard

7   for a TELRIC compliant UNE rate, i.e., the reference state, is the state that

8   has already received 271 authority from the FCC. In every case in which

9   the FCC has applied its methodology, the state for each ILEC to first

10   receive 271 authority serves as the standard (that is, Texas for all

11   Southwestern Bell states and New York for all Verizon states).

12 Q. WHY DOES THE FCC USE THE HCPM TO COMPARE COSTS

13   ACROSS STATES?

14 A. The operating principle underlying the FCC's analysis is that relative UNE

15   rates between states should be consistent with relative cost differences,

16   and that these relative cost differences are reasonably measured by the

17   HCPM. As the FCC indicated:

18   Our USF cost model provides a reasonable basis for
19   comparing cost differences between states. We have
20   previously noted that while the USF cost model should not

5

1   be relied upon to set rates for UNEs, it accurately reflects the
2   relative cost differences among states (emphasis added).[1]

3

4   When evaluating UNE rates within the context of a 271 application, the

5   Commission employs its USF cost model to compare UNE rates in the

6   applicant state with rates in other states which the Commission has found

7   to comply with the TELRIC standard. If the difference in rates is roughly

8   equal to the differences in costs, then the FCC declares the rates to be

9   TELRIC compliant (or consistent with what a TELRIC analysis would

10   produce).

11 Q. **PLEASE PROVIDE EXAMPLES OF HOW THE TELRIC TEST IS**

12   **APPLIED.**

13 A. The FCC applied its "TELRIC Test" in the orders approving 271

14   applications in Oklahoma/Kansas and Massachusetts. In Oklahoma, the

15   FCC evaluated the UNE loop rate, whereas in Massachusetts the loop and

16   switching UNE rates were scrutinized with the TELRIC Test For

17   Oklahoma, the FCC expressed concern that the loop rate difference

18   between Oklahoma and Texas was not cost justified:

19   In taking a weighted average of loop rates in Oklahoma and
20   Texas, we find that Oklahoma's rates are roughly one-third
21   higher than those in Texas (ft. omitted). ... Using a weighted
22   average of wire-center loop costs, the USF cost model

_____

[1] FCC KS-OK 271 Order, ¶ 84.

1   indicates that loop costs in SWBT's Oklahoma study area are
2   roughly 23 percent higher than loop costs in its Texas study
3   area (ft. omitted). We therefore attribute this portion of the
4   differential, roughly two-thirds of it, to differences in costs.
5   The remainder of the differential, however, is not de
6   minimus, and we cannot ignore its presence. [2]

7

8   In this statement, the FCC expressed concern that the difference in loop

9   rates was not cost justified, where costs are measured with the HCPM.

10   During the 271-review process, SBC "voluntarily" reduced its loop rates in

11   Oklahoma. With respect to the reduced loop rates in Oklahoma, the FCC

12   concluded:

13   The weighted average of the Oklahoma discounted loop
14   rates is roughly 11 percent higher than the weighted average
15   of the loop rates in Texas. This differential between
16   Oklahoma promotional and Texas rates is well within the 23
17   percent differential suggested by the USF cost model, and so
18   we conclude that the discounted rates meet the requirements
19   of the Act. [3]

20

21   After the voluntary rate reduction in the Oklahoma loop rate, the 11% rate

22   difference was below the 23% cost difference estimated by the HCPM. As

23   a consequence, the FCC deemed the loop rate to be TELRIC compliant.

24 Q. HOW WAS THE TELRIC TEST APPLIED IN THE MASSACHUSETTS

25   271 ORDER?

---

[2] FCC KS-OK 271 Order, ¶ 83-5.

[3] FCC KS-OK 271 Order, ¶ 86.

1   A.   During the review of the Massachusetts 271 application, Verizon

2   "voluntarily" reduced its switching rates during the Massachusetts 271

3   proceeding to a level consistent with that of New York. The FCC

4   concluded that the New York switching rates were appropriate for

5   Massachusetts because:

6   [a] weighted average of Verizon's voluntarily-discounted
7   Massachusetts rates ... and corresponding rates in New York
8   shows that rates in Massachusetts are roughly five percent
9   lower than those in New York. A comparison based on the
10   USF model of costs in Verizon's study area in Massachusetts
11   and New York for these same elements indicates that the
12   costs in Massachusetts are roughly the same as the costs in
13   New York. [4]

14

15   Again, the relative cost difference as measured by the HCPM was used to

16   evaluate the relative rate differences across states. The FCC also used the

17   TELRIC test to evaluate the loop rates in Massachusetts.

18   Q.   DID THE FCC USE THE TELRIC TEST TO EVALUATE THE RATES

19   IN THE ARKANSAS AND MISSOURI 271 ORDER?

20   A.   Yes. The FCC determined, for example, that the Missouri loop rate

21   compiled with TELRIC by performing the TELRIC Test with Texas as the

22   reference state:

---

[4] FCC Massachusetts 271 Order, ¶ 25.

8

1	We conclude that Missouri's recurring UNE rates fall within
2	the range that TELRIC-based ratemaking would produce.
3	With respect to loops, in taking a weighted average in
4	Missouri and Texas, we find that Missouri's rates are slightly
5	higher than those in Texas. The weighted average rates for a
6	2-wire analog loop in Missouri and Texas are $15.18 and
7	$14.10, respectively. The Missouri loop rate is just under 8
8	percent higher than the Texas loop rate. The USF cost model,
9	however, suggests that Missouri loop costs are nearly 20
10	percent higher than the Texas loop costs. Because the
11	percentage difference between Missouri's rates and Texas'
12	rates does not exceed the percentage difference between
13	Missouri's costs and Texas' costs, SWBT has met its burden
14	regarding the benchmark test using our USF cost model for
15	recurring loop rates.[5]

16   Clearly, the TELRIC Test continues to be an important tool for the

17   FCC's 271 evaluation.

18 **Q.   HOW IS THE TELRIC TEST PERFORMED?**

19 A.   Put simply, the TELRIC Test simply compares the ratio of UNE rates to

20   UNE costs between two states, where costs are measured by the HCPM. If

21   there are two states, state X and Y, then the TELRIC Test is simply

$$\frac{RATE\_X}{RATE\_Y} \leq \frac{COST\_X}{COST\_Y}$$

23   where the ratio of UNE rates ("RATE") is less than or equal to the ratio of

24   UNE costs ("COST"). For example, consider the Oklahoma and Texas loop

25   comparison. The FCC determined that the UNE rates in Oklahoma were

26   "roughly one-third higher than those in Texas," implying that the ratio of

---

[5] ARMO Order, ¶59.

1   UNE rates was 1.33 (= RATE_OK/RATE_TX). The HCPM indicated,

2   however, that loop costs are only "23 percent higher than loop costs" in

3   Texas, implying that the ratio of costs was only 1.23 (=

4   COST_OK/COST_TX). Obviously, 1.33 is not less than or equal to 1.23,

5   leading the FCC to express concern over the initial Oklahoma loop rate.

6   Once the Oklahoma loop rate was reduced "voluntarily", the ratio of UNE

7   rates was only 1.11, which is below the cost ratio of 1.23. Thus, the

8   reduced Oklahoma loop rate passed the TELRIC Test.

9 Q. **HOW DOES THE FCC CHOOSE A REFERENCE STATE FOR ITS**

10   **COMPARISON?**

11 A. In the recent Arkansas-Missouri 271 Order, the FCC set forth the relevant

12   criteria for choosing a reference state:

13   A comparison is permitted when the two states have a
14   common BOC; the two states have geographic similarities;
15   the two states have similar, although not necessarily
16   identical, rate structures for comparison purposes; and the
17   Commission has already found the rates in the comparison
18   state to be reasonable.[6]

19

20 Q. **WHAT IS THE SIGNIFICANCE OF THESE EVALUATIONS BY THE**

21   **FCC TO THIS CASE?**

---

[6] ARMO Order, ¶56.

1 A.   The significant point is that, where underlying costs have been measured

2   by the HCPM and can be correlated, material disparities between or

3   among the rates developed for different states are relevant to the

4   consideration of whether a particular rate complies with the TELRIC

5   standard.

6 Q.   **THE FCC HAS NOT APPROVED A BELLSOUTH 271 YET. HOW CAN**

7   **YOU PERFORM THE TELRIC TEST FOR FLORIDA?**

8 A.   Even in the absence of a FCC-approved "reference state," and without

9   indicating a view as to whether the rates in Georgia or Louisiana comply

10   with the TELRIC standard, the same comparison employing HCPM data

11   provides a useful tool with which to help gauge arguments concerning

12   whether the Florida rate would comply with the FCC's TELRIC standard.

13 Q.   **WHAT DOES THE TELRIC TEST SAY ABOUT THE LOOP RATE IN**

14   **FLORIDA?**

15 A.   The current statewide average loop rate in Georgia for a UNE-P customer

16   is $12.55. In Louisiana, the rate is $14.94. The current rate for Florida is

17        $13.97. As previously mentioned, the HCPM indicates the cost of a loop

18   in Florida is a maximum rate of about 9% less than in Georgia and 24%

19   less than in Louisiana. Applying the test, the TELRIC Test ceiling standard

20   for the loop rate in Florida is about $11.40 ($11.37 with Georgia as a

11

1   reference and $11.30 with Louisiana as a reference). In other words, the

2   loop rate would have to be at or below $11.40 to pass the sanity test. Thus,

3   the current loop rate for BellSouth Florida is at least 23% too high

4   (= 13.97/11.40). I have displayed these relationships in Exhibit __ (GSF-1).

5   Observe in Exhibit __ (GSF-1) that the loop cost in Georgia is about 83% of

6   the loop cost in Louisiana, according to the HCPM. The ratio of loop rates

7   in those states matches, almost identically, this cost difference (a ratio of

8   0.83). Only Florida is an outlier in the group.

9   Q.   WHAT DO YOU CONCLUDE FROM THIS EXERCISE?

10   A.   I believe the fact that BellSouth's loop rate fails this sanity test

11   demonstrates the need to critically review BellSouth's rate. It is my

12   understanding that witness Brian Pitkin will address a number of specific

13   flaws and   questionable inputs in BellSouth's model.

14   Q.   IF THE COMMISSION FAILS TO LOWER BELLSOUTH'S UNE LOOP

15   RATE, WHAT EFFECT WILL THE INFLATED LOOP CHARGES

16   HAVE ON Z-TEL'S ENTRY INTO FLORIDA?

17   A.   I think most everyone thought that the Telecommunications Act was only

18   about competition among telecommunications companies. Now, with the

19   extremely limited human and financial resources of the CLEC industry, a

20   form of competition between states for competitive entry is emerging.

12

1   CLECs possess limited resources for marketing and selling their services.

2   In the current capital market environment, CLECs have access to very

3   limited resources that may be directed to typical market-entry tasks, such

4   as marketing, sales, etc.   For CLECs like Z-Tel, which has the ability to

5   provide residential local service in over thirty states, the decision of which

6   state to direct human and financial resources is a function of the potential

7   margins in any particular state. States will relatively high UNE rates run

8   the risk that entry will not happen, as CLECs devote resources to states

9   with more attractive economics. In this proceeding, there is a danger that

10   the Commission approve a relatively high loop rate that not only

11   frustrates BellSouth's 271 prospects, but moves Florida down in the

12   ranking of attractive markets. While I am not prepared to prognosticate

13   the future of competition in Florida, it does not take any leaps in logic to

14   determine that Z-Tel would be more active in entering Florida at a loop

15   rate of $11.40 or less than it will be at a loop rate of $13.97.

16   Q.   DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

17   A.   Yes.

TELRIC Test Compliant Loop Rate for BellSouth Florida			
	UNE Rate for UNE-P Loop	HCPM Cost	TELRIC Test Compliant
Florida	$13.97	$17.21	$11.40
Georgia	$12.55	$18.98	...
Louisiana	$14.94	$22.75	...

Source: Georgia Order No. 10692-U, Feb. 1, 2000. Louisiana Docket No. 24714, BellSouth Compliance Filing, Sept. 24, 2001.

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing Testimony of George S. Ford on behalf of Z-Tel Communications, Inc. has been furnished by (*) hand delivery, or U.S. Mail this 7th day of December, 2001, to the following:

(*) Beth Keating
Florida Public Service Commission
Division of Legal Services
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0850

Jeffrey Wahlen/John Fons
Ausley Law Firm
Post Office Box 391
Tallahassee, Florida 32302

Nancy B. White
c/o Nancy H. Sims
BellSouth Telecommunications, Inc.
150 South Monroe Street, Suite 400
Tallahassee, Florida 32301

Norton Cutler
BlueStar Networks, Inc.
5 Corporate Centre
801 Crescent Centre Drive, Suite 600
Franklin, TN 37067

Elise Kiley/Jeffrey Blumenfeld
Blumenfeld & Cohen
1615 Massachusetts Avenue, NW
Suite 700
Washington, DC 20036

John Spilman
Broadslate Networks of Florida, Inc.
675 Peter Jefferson Parkway, Suite 310
Charlottesville, VA 22911

Catherine F. Boone
Covad Communications Company
10 Glenlake Parkway, Suite 650
Atlanta, GA 30328

Florida Cable Telecommunications Assoc.
Michael A. Gross
246 E. 6th Avenue, Suite 100
Tallahassee, Florida 32303

Florida Digital Network, Inc.
390 North Orange Avenue, Suite 2000
Orlando, Florida 32801

Richard Melson
Hopping Law Firm
Post Office Box 6526
Tallahassee, Florida 32314

Donna C. McNulty
MCI Worldcom
The Atrium, Suite 105
325 John Knox Road
Tallahassee, Florida 32303-4131

Charles Pellegrini/Patrick Wiggins
Katz, Kutter Law Firm
12th Floor
106 East College Avenue
Tallahassee, Florida 32301

Jonathan Canis/Michael Hazzard
Kelley Law Firm
1200 19th Street NW, Fifth Floor
Washington, DC 20036

Brian Sulmonetti
Concourse Corporate Center Six
Six Concourse Parkway, Suite 3200
Atlanta, GA 30328

Norman Horton, Jr./Floyd Self
Messer Law Firm
Post Office Box 1876
Tallahassee, Florida 32302

Don Sussman
Network Access Solutions Corporation
Three Dulles Tech Center
13650 Dulles Technology Drive
Hemdon, VA 20171-4602

Marc W. Dunbar
Pennington Law Firm
Post Office Box 10095
Tallahassee, Florida 32302

Catherine Muccigrosso
Rhythms Links Inc
6933 South Revere Parkway, Suite 100
Englewood CO 80112-3981

Rodney L. Joyce
Shook, Hardy & Bacon LLP
600 14th Street, NW
Suite 800
Washington, DC 20005-2004

Charles J. Rehwinkel
Sprint-Florida, Incorporated
1313 Blairstone Road
Tallahassee, Florida 32301-3021

Mark E. Buechele
Supra Telecommunications and Information
Systems, Inc.
Koger Center - Ellis Building
1311 Executive Center Drive, Suite 200
Tallahassee, Florida 32301-5027

Michael Sloan
Swidler & Berlin
3000 K St. NW, #300
Washington, DC 20007-5116

Carolyn Marek
Time Warner Telecom of Florida, LP
233 Bramerton Court
Franklin, TN 37069

Kimberly Caswell
Verizon Select Services, Inc.
Post Office Box 110, FLTC0007
Tampa, Florida 33601-0110

George S. Ford
Z-Tel Communications, Inc.
601 S. Harbour Island Boulevard
Tampa, Florida 33602-5706

Joseph A. McGlothlin
Joseph A. McGlothlin