HARRIS,
WILTSHIRE &
GRANNIS LLP

1200 EIGHTEENTH STREET, NW
WASHINGTON, DC 20036

TEL 202.730.1300 FAX 202.730.1301
WWW.HARRISWILTSHIRE.COM

ATTORNEYS AT LAW

December 16, 2002

EX PARTE – Via Electronic Filing

Ms. Marlene Dortch
Secretary
Federal Communications Commission
The Portals
445 12th Street, S.W.
Washington, DC 20554

Re: CC Docket Nos. 01-338, 96-98, 98-147

Dear Ms. Dortch:

On December 13, 2002, Rob Curtis and Tom Koutsky of Z-Tel and Tim Simeone and I met with Commissioner Adelstein and Eric Einhorn. Later in the day, Messrs. Koutsky and Simeone and I met with Commissioner Abernathy and Matt Brill. We distributed and discussed the attached documents at these meetings, along with some others that had previously been filed in these dockets.

In accordance with FCC rules, a copy of this letter is being filed in the above-captioned dockets.

Sincerely,

/s/
Christopher J. Wright
Counsel to Z-Tel Communications, Inc.

Z-Tel and UNE-P Applications

Robert Curtis
Thomas M. Koutsky
Christopher J. Wright
Timothy J. Simeone
Z-Tel Communications, Inc

December 13, 2002

Z-Tel: Quick Facts

- Leading UNE-P-based services provider headquartered in Tampa, Florida
- 925 Employees with $41K annual average salary
- **200,000 current retail residential and small business lines in service in 46 states**
- **We own facilities and develop services -- and we utilize UNE-P to connect mass-market customers in 46 states to them**
- Key partner behind The Neighborhood™ built by MCI
- Founded in 1998 & public since December 1999
- $250MM annual revenue
- EBITDA positive w/ minimal debt
- **Innovation:** unique Internet-accessible calling and messaging features
- **The Future:** voice recognition dialing, personal and organizational directories

Agenda

- UNE-P is the only effective method to provide choice to rural, residential, and small business customers.
- Section 271 requires the BOCs to unbundle the network elements comprising the platform.
- The States have an important role to play in making unbundling and pricing decisions.
- The Commission's goal should be to foster the development of wholesale markets.
  - Z-Tel has presented a five-step plan.
- Z-Tel research on UNE-P shows that it promotes investment in facilities as well as enabling competition.

Mass Market Granular Analysis

- Z-Tel seeks to provide its innovative telecom software to mass market residential and small business customers (DS0s)
- "Mass market" distinct from "large business market"
  - *Distinction made in FCC Merger Orders (BA/GTE, SBC/Ameritech)*
  - *Verizon admits unbundling analysis for "traditional wireline" must be different than for large business/broadband*
  - *Requirements to Serve of Mass Market Unique*
    - *Very High Churn (MCI 11/15/02 ex parte) – several % per month*
    - *No long-term contracts*
    - *High quality – no tolerance for failures*
    - *Low revenue/month*
- No party defends the "three-line rule" rule
  - *The line between small businesses and others is where is where it becomes efficient to install a DS1 (about 18 lines)*

UNE-P as Rural Entry Method

State	Urban UNE-P Lines	Suburban UNE-P Lines	Rural UNE-P Lines
Michigan	140,675	309,067	374,818
Illinois	12,562	181,991	331,813
Texas	447,076	678,015	284,506
Ohio	69,433	79,846	129,387
Indiana	18,794	22,510	19,772
Wisconsin	12,436	37,361	14,995
Missouri	92,130	32,195	13,770
Oklahoma	51,154	7,383	5,396
Kansas	91,698	47,899	5,391
California	132,200	146,083	5,371
Arkansas	10,314	38,370	1,549
Nevada	31	20	1
Total SBC 3,851,022	**1,078,503**	**1,580,740**	**1,186,719**

UNE-P Residential Entry

State	Urban Res/UNE-P Lines	Suburban Res/UNE-P Lines	Rural Res/UNE-P Lines
Michigan	123,036	253,530	319,249
Illinois	4,893	144,243	269,753
Texas	328,552	476,833	210,445
Ohio	55,700	62,433	108,754
Indiana	17,553	17,657	16,479
Wisconsin	10,778	31,447	11,538
Missouri	27,536	14,222	8,944
Oklahoma	17,656	3,742	1,205
Kansas	53,056	29,080	2,757
California	75,384	93,721	2,792
Arkansas	8,581	34,807	1,454
Nevada	18	20	1
Total SBC 2,840,184	**722,743**	**732,585**	**953,371**

Hot Cuts: the record…

- Barrier to Entry: ILECs have mechanized way of providing mass-market service to customers. Denying CLECs mechanized access and requiring manual processes erects classic barrier to entry
- This Barrier to entry qualifies under *USTA* -- as it stems from ILEC's monopoly
- Manual hot-cuts insufficient to handle scale, quality, and efficiency of mechanized process
- Bell company hot-cut "proposals" inadequate
  - Verizon has only proposed to deploy an automated electronic tracking system – *underlying provisioning system still manual*
  - SBC offers 1 million hot cuts per year in Ameritech territory – *this would cap CLEC mass-market share at less than 8%!*
  - BellSouth has proposed a "trial"

Section 271 Requires the Bells to Provide UNE-P

- Regardless of the results of the impairment analysis, the BOCs must provide access to the network elements comprising the platform
  - The section 271 checklist specifically requires BOCs to unbundle loops, switching, and transport
  - The legislative history says the checklist sets forth what a BOC must provide "at a minimum … in any interconnection agreement approved under section 251"
  - The FCC previously concluded that BOCs must provide access to unbundled switching even in circumstances where it need not be offered under section 251
- Verizon recognized that section 271 means what it says by filing a forbearance petition
  - But the record in that separate proceeding shows that sections 251(c)(3) and 271 have not been "fully implemented" and won't be until wholesale markets exist.
- FCC erroneously concluded that BOCs need not provide network elements at cost-based rates. Congress…
  - Intended the cost-based pricing rule it established in 1996 for network elements to be applied.
  - Did not intend that the Commission instead use a 1934 provision governing interstate rates.

State Commissions Must Play a Role

Section 252

- The State Commissions arbitrate interconnection agreements, which set forth a list of network elements and the price for leasing those elements.

Section 251(d)(2)

- The ***USTA*** and ***CompTel*** decisions: Section 251(d)(2) requires granular analyses beyond the capabilities of the FCC.
  - ***USTA*:** FCC erred by adopting rules of "unvarying scope" that were "detached from any specific markets or market categories."
  - ***CompTel***: Section 251(d)(2) "invite[s] an inquiry that is specific to particular carriers and services."
- States can **help** FCC write rules that pass legal muster by doing fact-finding to determine whether impairments continue to exist – with particular focus upon whether reduction in output would occur in their states

Section 251(d)(3)

- Regardless of the section 251(d)(2) analysis, Congress preserved the states' right to establish additional unbundling obligations.
- *Iowa Utilities Board*: In a portion of its opinion that was not overturned, the Eighth Circuit held that the FCC could not preempt state unbundling rules merely because they differ from FCC rules.

UNE-P…The Future

- Consumers only now beginning to see choice – 8MM UNE-P lines to date
- New and innovative service providers like Z-Tel account for 43% of all UNE-P lines
- Consumers don’t demand network facilities – service providers do.
- Independent UNE-P carriers serving mass market demand *and will migrate* to independent, non-ILEC sources when those non-ILEC sources can provide seamless access in sufficient quantities
- The solution is to develop **vibrant, effective and efficient wholesale, non-ILEC alternatives**
- The presence of Z-Tel and UNE-P **facilitates** wholesale development – and public policy can help

A Five Step Plan to Wholesale Alternatives

Step 1. **Resolve loop access impairment**
Step 2. **Competitive transport markets**
Step 3. **Migration by Switch-Based CLECs**
Step 4. **Wholesale competitive analysis**
Step 5. **Transition by all carriers**

- Steps must be taken "in order"
- Focus on mass-market DS0 switching/shared transport
- State commission fact-finds and adjudicates each step
- Avoid pitfalls of 271 process (notice filings, social promotion)
- Establish path to ultimate deregulation

Step 1:
Resolve Loop Impairment

- State commission must determine that ILEC can provide DS0 loops in a --
  - Cost-effective
  - Reliable
  - Timely, and
  - Scalable manner
- Wholesale market for mass-market local switching/transport cannot develop unless efficient and effective access to DS0 loops
- Manual process amounts to classic barrier to entry
  - AT&T conservatively estimated $7/mth per line difference
  - Result: 31% diminution of CLEC market share
- Scale matters
  - Volume of hot-cuts not tested in 271 proceedings
  - SBC's "offer" of 1 million hot-cuts per year in Ameritech region would limit CLECs to <8% market share

Step 2:
Competitive Transport Markets

- Wholesale providers must not be dependent upon ILEC-provided interoffice transport
- CompTel/ALTS test for competitive alternatives to interoffice transport should be completed by State commission *before* ILEC permitted to proceed to Step 3
- Analysis must be undertaken separately for dedicated and shared transport

Step 3: Switch-Based CLEC Migration

- ILEC makes *prima facie* showing to state commission of satisfaction with Steps 1 and 2 with regard to particular central office
- State commission examines and, after opportunity for discovery and hearings, makes preliminary determination of ILEC compliance – then…
- Entrant that has **already** collocated and deployed in that central office the necessary equipment, software and facilities to switch DS0 circuits should be required, where cost-effective and non-customer effecting, to begin to migrate DS0 UNE-P lines to that switch
- State commission supervises migration – if ILEC fails in provisioning, reversion back to Step 1
- Benefits
  - Ramp up and test ILEC loop provisioning systems in real-world setting
  - Encourage development of non-ILEC sources of supply

Step 4: Wholesale Market Analysis

- Once all Step 3 migrations completed, ILEC may for that central office petition State commission for determination that a vibrant, effective and efficient wholesale alternatives for DS0 switching and transport exists in that office

- State commission competitive analysis:
  - At least ***five*** non-ILEC providers that provide substitutable wholesale service for DS0 switching and transport interconnected with ILEC loops are present
  - The five wholesale providers have sufficient personnel and resources to provide wholesale service and each have done so for at least 100 DS0s in that office
  - Wholesale providers have sufficient capacity to serve retail CLEC demand
  - Transfer to wholesale providers can be accomplished seamlessly and cost-effectively

- Five provider requirements based on game theory, Cournot models of competition, and presence of lack of complete information *ex ante*

Step 5: UNE-P Transition Process

- CLECs file transition plans with State commission within six months of completion of Step 4 in a CO
- State commissions accept plans or grant exceptions
- ILEC obligated to provide UNE-P while transitions in progress
- If during transition ILEC fail to provide seamless, cost-effective cutovers, State commission shall suspend all transition for at least six months
- Three Strikes: third time an ILEC fails in its obligations in any CO for a third time, ILEC immediately reverts back to Step 1 and must provide UNE-P

Z-Tel Research on UNE-P

- ***Residential/Small Business Competitive Entry greater where UNE Platform available without restriction***
  - Z-Tel Policy Paper No. 3
  - Data: FCC Local Competition Reports

- ***UNE-P promotes facilities investment***
  - Z-Tel Policy Paper No. 4
  - Data: looks at switch deployment over time, using FCC Local Competition data, LERG

- ***Bells make money selling UNE-P to Z-Tel***
  - September 23 and 30, 2002 Z-Tel ex parte letters to Chairman Powell
  - Beard & Klein, Phoenix Center Policy Paper No. 17
  - SBC CFO confirms that in Texas – ***where UNE-P has been and is now available without restriction*** – SBC has sufficient incentive to invest at $20/21 per month

More Research…

Lower UNE prices do not "discourage" facilities-based entry

- Beard, Ford and Koutsky, *Facilities-Based Entry into Local Telecommunications* (2002) (attached to Z-Tel Comments)
  - Study also supports findings of Policy Paper No. 4
  - Data: FCC Local Competition data, LERG, state UNE prices
  - **Study entirely unrebutted the record**
- Pelkovits and Ford, *Unbundling and Facilities-Based Entry by CLECs* (2002)
  - Data: ARMIS, FCC Form 477 data (latest available data)

Unbundling and "facilities-based" entry are not substitutes

- Beard and Ford, *Make or Buy? Unbundled Elements as Substitutes for Competitive Facilities* (2002)
- Data: UNE-P Fact Report, FCC Form 477 data and UNE pricing data
- Estimated demand curves for unbundled loops purchased with switching (UNE-P) and without switching (UNE-L)
- Comparing elasticity of these curves indicates whether CLECs view UNE-P and UNE-L as substitute forms of entry, or whether they are different forms of entry to serve different markets
- Results: **UNE-P and UNE-L are not substitute entry strategies**
- In other words, taking away UNE-P will not increase UNE-L competition – indeed, forced migration to UNE-L risks unserving the market UNE-P currently supports

Basic Report
Wireline Telecommunications

September 20, 2002

SBC Communications Inc. *

Coverage Initiated With a Rating of Market Performer

- **We initiated coverage of SBC Communications Inc. on September 19, 2002, at a price of $24.30, with a rating of Market Performer.** We view SBC as a survivor, consolidator and long-term dominator of the telecom industry. The clarity of SBC's long-term destiny is clouded, however, by the present effects of diverse competition, elbowing SBC out of its comfort zone in the local market. This shift is forcing pursuit of new growth avenues: balancing cash outlays and start-up losses with dividend distributions and earnings.
- **The company faces ongoing challenges to its core local telephony base.** SBC's core wireline operations generate roughly 75% of normalized revenue and EBITDA, but share loss has been accelerating and stands at 1% per quarter. Save for unexpected major regulatory change, it is unclear if even macro recovery can lift pressure on the consumer local business.
- **SBC has identified wireless and data as growth opportunities to offset declines in consumer local, but plans are still developing.** SBC's wireless business Cingular is grappling with industrywide price pressure and subscriber quality issues. The company's data opportunity has increased with WorldCom's demise and will increase further with in-region long distance authority. However, this business will take time to ramp up.
- **We believe the risks and uncertainties are understood and largely priced in.** Investors are paid to hold SBC, with a 4.6% yield that is very safe, based on the company's superior free cash generation. What investors are holding on for are SBC's initiatives to develop an enterprise presence, develop in-region data and LD opportunities and to deploy the defensive bundling of voice, data and wireless to stem consumer retail line losses.

Market Performer

SBC (NYSE): $23.38

David W. Barden, CFA
(212) 847-5890
dwbarden@bofasecurities.com

Joseph Bender
(212) 583-8453
joe.bender@bofasecurities.com

Robert Dezego
(212) 847-5702
rdezego@bofasecurities.com

Company Data	
12-Month Target Price	N/A
52-Week Range	$48-22
Secular Growth (EPS)	5%
Market Cap.	$78.4 BB
Avg. Daily Vol.	9,186,260
Debt/Cap. (9/02)	44.8%
Dividend/Yield	$1.08/4.6%

Index Data	
DJIA	7942
S&P 500	843

FYE Dec	2001	2002E	2003E
EPS			
Q1 (Mar)	$0.51	$0.51A	
Q2 (Jun)	0.61	0.61A	
Q3 (Sep)	0.59	0.55	
Q4 (Dec)	0.63	0.60	
Fiscal Year	$2.34	$2.27	$2.22
Calendar Yr	$2.34	$2.27	$2.22
P/E	10.0	10.3	10.5

Please see the important disclosures at the end of this report. Investors should assume that Banc of America Securities is seeking or will seek investment banking or other business from companies rated in this report.

market share quickly from the incumbents RBOCs. AT&T has now entered eight states to compete as a UNE-P CLEC. MCI reported adding over 1 million new UNE-P customers as of September 18, 2002 and continues to scale despite its current bankruptcy status. All totaled by the end of the second quarter, we estimate that UNE-P customers exceeded 8 million, or slightly less than 5.0% market share, up from 3.3% nationwide penetration at year-end 2001. UNE-P momentum remains strong, and unless the regulatory winds shift following the FCC's triennial review and assessment of the competitive landscape, SBC faces a formidable battle ahead. Other issues the FCC is likely to consider during its evaluation of UNE-P under its triennial review include the impact on universal service funding, incentives for facilities-based investment and the potential impact UNE-P is having on equipment manufacturers.

Bundling Is the Defense

SBC believes its biggest competitive advantage to reducing local service customer churn is its ability to offer bundled service packages. Conventional wisdom suggests that bundled package offerings build customer loyalty, create customer stickiness and reduce churn. The various permutations include local-long distance, local-DSL and DSL-Internet access. Consumers are thought to value bundled service offerings because they generally offer multiple services at a discount to stand-alone prices if the services were purchased separately. During our recent meeting with management, SBC cited that its local customers purchasing DSL have a churn rate 75% lower than that of the average SBC customer not purchasing DSL. But AT&T and WorldCom as well as the cable companies are well heeled to offer similar service packages and are subscribing to the same bundling mantra. Relative to its competitors, SBC contends that its bundling weapon is its ability to bundle wireless service with any of its other services, which it sees as an unrivaled primary competitive advantage.

Of course, SBC must overcome customer sticker shock associated with receiving a single bill for multiple telecommunications services. Customers may not like receiving a single bill, for example, of $200 or more per month, and could reconsider where they can cut back to save money potentially during tighter economic times. AT&T was one of the first carriers to subscribe to the notion of being a one-stop shop for a customer's entire communications needs. Since then AT&T has spun off its wireless operations and is in the final stages of selling its cable operations to Comcast. It is possible AT&T came to market too early, but more than likely, management confronted some customer resistance to relying on one carrier for all their communications services. Nonetheless, SBC is banking on bundled services to stem access line losses. Aggressive strategic marketing campaigns are planned and will be targeted toward winning back customers lost to UNE-P competitors. SBC also noted that its local win-back rate is 50% higher in its Southwestern Bell states where it is able to offer long distance service versus states where it still lacks 271 authority.

SBC's strategy for winning the battle on the local service frontier is premised not necessarily on winning back all customers lost, but increasing its competitor's churn rate. In SBC's estimation, UNE-P, at current regulated rates, can only be profitable based on the assumption that the CLEC's customer churn does not exceed 3%. The rationale is that alternative carriers incur substantial up-front nonrecurring customer acquisition costs that will become too prohibitive if the average UNE-P customer life is shortened significantly. Presently, SBC believes that if it can compete aggressively enough to ratchet up UNE-P churn rates from 3% to 5% it can severely impair the UNE-P CLEC model, spoiling its ability to recoup up-front fixed costs and reducing a CLEC's prospects for achieving long-term profitability.

Quantifying the Impact of UNE-P

SBC's disclosure of access lines on a state-by-state basis made it possible to estimate with a greater degree of accuracy the revenue impact UNE-P will have on SBC's consolidated local operations going forward. Our analysis captures the impact of SBC's changing local services revenue mix as the company shifts toward becoming a hybrid retail-wholesale service provider.

The foundation for our analysis was to look at SBC's local access lines on a state-by-state basis. SBC provides a breakdown of retail and switched lines by state, the difference between which equals the sum of its payphone, total service resale and UNE-P lines. We proceeded to allocate the totals for each line category across SBC's 13-state ILEC footprint. We began this effort by referencing the SBC's Form 477 Filing (local competition), which SBC and the other RBOCs must file with the Commission. The FCC requires carriers to file this form on a semiannual basis and the data included in the filing serves as the basis for the FCC's semiannual *Local Competition Report*. The filing includes the number of UNE-P lines reported by each RBOC, breaking them down by state. Because the most recent data available from the FCC are through year-end 2001, we started by comparing SBC's reported consolidated number of UNE-P lines to the sum of the total UNE-P lines reported by state to the FCC. We reconciled the 17,000 UNE-P access line count difference, and then allocated resale and payphone lines per state to foot SBC's total line counts for these two classes of lines. Finally, we trued up the UNE-P lines for each state to coincide with the total lines reported at the end of the second quarter using SBC's consolidated six-month UNE-P line growth rate.

We then sourced the National Regulatory Research Institute's (NRRI) most recent *Survey of Unbundled Network Element Prices* report, which catalogues each state's weighted average monthly UNE-P rate (the rate is averaged across each state's various density zones permissible under geographic rate deaveraging). Multiplying each of the state's UNE-P lines at the end of the second quarter of 2002 by their respective UNE-P rate, we estimated total wholesale revenues in the quarter attributable to UNE-P.

Next, we estimated separately the weighted average revenue per line for a single residential line and for a single business line based on company guidance parameters. For purposes of our analysis, we estimate $37 per month per residential access line and $54 per month per business access line. Unlike our estimates for UNE-P monthly per line revenue per state, retail line revenues include various regulatory charges including the subscriber line charge (SLC) and Universal Service Fund fee revenues. Our per-line retail estimate also includes revenues from ancillary services such as long distance (both intraLATA and interLATA toll), vertical service calling features and Internet access. Because the residential market is disproportionately affected by UNE-P relative to the business market, we estimated a blended weighted average per line to estimate forgone retail revenues when a line is converted from retail to UNE-P.

We estimate that SBC is losing, on average, approximately $23 per line per month in retail revenues when it loses an access line to a UNE-P competitor. Consistent with company guidance and AT&T's recent comments about the residential-business mix of UNE-P lines, we estimate that 85% of UNE-P lines are attributable to the residential market and 15% are business lines. This implies a blended weighted average monthly revenue per retail line of slightly less than $40, compared to our estimate of about $17 of monthly revenue per UNE-P line.